

Handbook



Naval Audit Service

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101 -- PURPOSE OF INTERNAL AUDIT

The purpose of internal audit is to provide independent, objective, and constructive verification regarding the:

- Accomplishment of management objectives.
- Integrity and reliability of program management and financial data.
- Safeguarding and efficient use of resources.
- Adequacy and effectiveness of policies, procedures, and internal controls.
- Extent of compliance with policies, procedures, laws, and regulations.
- Causes of inefficiencies or uneconomical practices.

102 -- RESPONSIBILITIES**1. Audit work.**

- a. [Secretary of the Navy Instruction 7510.7 \(Series\) \(DON Internal Audit\)](#) states that the internal audit function within the Department of the Navy is the responsibility of the Auditor General of the Navy. The Naval Audit Service, under the direction of the Auditor General, is the internal audit organization within the Department.

- b. The Auditor General of the Navy is responsible for: (1) conduct of the audit production function within the Department of the Navy; (2) the audit standards, policies, and procedures required to provide audit coverage of all Department of the Navy organizations, programs, activities, and functions, including nonappropriated fund organizations; and (3) evaluating whether audit work, inclusive of audit services provided under Department of the Navy contracts, meets the established standards. Guidance on internal audit procedures is contained in this Handbook. Adherence to the prescribed procedures within this Handbook is mandatory for all internal auditors within the Department of the Navy, including local audit function auditors, unless specifically waived by the Auditor General. [NAVAUDSVC P- 7511.3 \(Series\) \(Local Audit Function Policies and Standards\)](#) applies to audit work accomplished by local audit function auditors.

2. Corrective action and followup.

- a. Responsibility for correcting a deficiency cited during an audit rests at the command level where the appropriate degree of authority and responsibility is available. The Naval Audit Service, the Assistant Secretaries of the Navy, the Chief of Naval Operations, the Commandant of the Marine Corps, and the various command elements have the responsibility to ensure that the appropriate activity takes necessary action and that the Naval Inspector General is so advised. The Naval Inspector General administers the followup system and has ultimate responsibility for ensuring that cited deficiencies are corrected.
- b. The Auditor General may evaluate the effectiveness of the Department's Followup System if reported deficiencies are going uncorrected. Naval Audit Service auditors will, on a selective basis, ascertain that corrective action was taken on recommendations to Navy and Marine Corps activities in Department of the Navy, Department of Defense, and General Accounting Office audit reports. [Secretary of the Navy Instructions 5200.34 \(Series\) \(Management of Audit Decision and Followup Functions\)](#) and [7510.7 \(Series\)](#) contain additional information on followup procedures.

103 -- AUDIT STANDARDS

Federal legislation and Office of Management and Budget guidance require that Federal auditors comply with Generally Accepted Government Auditing Standards (GAGAS) promulgated by the Comptroller General of the United States in its publication entitled Government Auditing Standards. This publication, commonly referred to as "[The Yellow Book](#)", provides guidance for conducting financial and performance audits. The "Yellow Book" contains fieldwork and reporting standards, as well as, general standards. [The Inspector General, DOD, \(DODIG\) Internal Audit Manual](#) implements the "Yellow Book" within the DOD. Naval Audit Service procedures for implementing the fieldwork and reporting standards of the "Yellow Book" and the DODIG Internal Audit Manual are discussed in the following chapters. An overview of these standards is as follows:

1. Independence. In all matters relating to audit work, the individual auditors should:

- a. Be organizationally independent.

To ensure organizational independence, the Auditor General reports directly to the Under Secretary of the Navy. The Auditor General establishes and maintains audit policies and procedures for management and auditing that ensure the Department of the Navy's internal audit process is carried out in an independent manner.

- b. Be free from personal or external impairments to independence.

(1) Personal impairments. A situation may arise in which an auditor may not be impartial because of his or her view (attitude) or personal situation. Managers and supervisors need to be alert for personal impairments of their staff members. Auditors are responsible for notifying their supervisor in writing if they have any personal impairment. Should questions arise about an auditor's independence on a specific audit, the circumstance(s) and corrective action(s) taken to address the impairment should be documented in the working papers.

(2) External impairments. Factors external to the audit organization may restrict the audit or interfere with an auditor's ability to form independent and objective opinions and conclusions. Auditors must report any external impairment to their immediate supervisor. Generally, the immediate audit supervisor will address impairments. However, when necessary for resolution, external impairments should be elevated to the responsible Assistant Auditor General.

- c. Maintain an independent attitude and appearance.

The audit staff must be constantly aware of the need to remove themselves from an audit if they have either personal or external impairments that bias their ability to remain independent or **when there is an appearance of impairment** that might lead knowledgeable third parties to question their independence.

2. Qualifications. This standard covers the need to have qualified people on audits and applies to individual auditors, the audit team as a whole, and outside experts.

- a. **Continuing education.** Auditors and the audit organization are responsible for maintaining professional proficiency through a program of continuing education and training. Individuals responsible for planning, directing, conducting, or reporting on government audits should complete, every 2 fiscal years, at least 80 hours of continuing education and training which contributes to the auditor's professional proficiency. At least 20 hours should be completed in any 1-year of the 2-year period. Individuals responsible for planning, directing, or conducting substantial portions of the field work, or reporting on government audits, should complete at least 24 of the 80 hours of continuing education and training in subjects directly related to the government environment and to government auditing.

b. Audit team makeup. The staff assigned to conduct an audit should collectively possess adequate professional proficiency for the tasks required. Professional auditors will be assigned to all supervisory positions. Each individual audit team member need not possess all the skills and knowledge necessary to complete the audit project.

c. Outside experts. When necessary to complete an audit in the most efficient and effective manner, Assistant Auditor Generals will obtain needed expertise from outside the Naval Audit Service (paragraphs [305.1c](#), [309.2](#) and [309.3](#) apply). **In no instance will outside experts have ultimate decision authority relative to an audit.**

3. Due professional care. Due professional care should be used in conducting audits and preparing related reports.

a. Extent of work. Audit steps and procedures should be designed to provide reasonable assurance of detecting errors, irregularities, and illegal acts that could have a direct and material affect on the operations under review. Auditors must be alert for situations or transactions that could be indicative of fraud, improprieties, inefficiencies, or ineffectiveness. Auditors are not required to audit all transactions or to give absolute assurance that no impropriety exists. However, audit staff members must audit in accordance with the procedures in this Handbook and exercise due professional care and sound professional judgement in selecting audit tests, procedures, and methodology, and in preparing reports. At a minimum, the choice of tests, procedures, and methodology requires consideration of:

- (1) What is necessary to achieve audit objectives? The scope of audit work must normally be limited to high-risk areas and be designed to provide reasonable assurance that material problems are likely to be identified and addressed.
- (2) Effectiveness of applicable internal controls and compliance with applicable laws and regulations.
- (3) Cost versus benefits of audit work being done.
- (4) Potential for detecting fraud and other illegal acts that could have a **significant impact on the audit objectives**.
- (5) Whether appropriate actions have been taken to correct findings and recommendations from previous audits.
- (6) Reporting timeframes that must be met consistent with client needs.

b. Materiality and significance. In determining materiality and/or significance and audit risk the auditor may consider:

- (1) Monetary value of an item and/or the amount of revenues and expenditures.
- (2) Newness of the activity, program, function or item and/or changes in its objectives or mission.

- (3) Adequacy of internal controls.
- (4) Results of prior audits.
- (5) Level and extent of review or other form of independent oversight.
- (6) Management's compliance with applicable laws and regulations.
- (7) Audit report users' expectations.
- (8) Public perceptions and political sensitivity of the areas under audit.
- (9) Audit requirements.
- (10) Cumulative effect and impact of nonmaterial items.

Paragraphs [402.3](#), [609](#), and [807](#) contain related guidance. Optional guidance on materiality is provided in the linked document entitled "[Determining Materiality for Financial Statement and Financial-related Audits](#)".

c. Quality of work. The quality of audit work and related reports depends upon the degree to which:

- (1) Supervisors discharge their responsibilities for planning, direct supervision of the work conducted, staff training, the judgements made during the audit, and the audit report.
- (2) Audits are properly designed to achieve planned objectives and are performed and supervised by competent persons. Where appropriate, statistical sampling, standardized data collection, statistical inference, quantitative techniques, and other aspects of quantitative analysis should be used.
- (3) The audit process conforms to Generally Accepted Government Auditing Standards for fieldwork and reporting as implemented in this Handbook. For example, findings and conclusions in reports must be fully supported by sufficient, competent, and relevant evidence obtained or developed during the audit.

104 -- ACCESS TO INFORMATION

1. General. Auditors are to have full and unrestricted access to all personnel, facilities, records, reports, databases, documents, or other information or material that a properly cleared auditor requests as being necessary to accomplish announced audit objectives. Access to automated data processing resources, inclusive of online workstations and programming personnel, should be available to the audit staff. Access to and training in the use of existing management (auditee) data-retrieval and report-generating capabilities should be available. All costs associated with accessing information and the costs of suitable office space and all other facilities needed to

support the audit function, will be provided by audited commands on a nonreimbursable basis. [Secretary of the Navy Instruction 7510.7 \(Series\)](#) provides additional details. The determination that access is necessary is the responsibility of the Project Manager.¹

2. Denials. Disagreements between auditors and managers regarding access to information must be elevated quickly by the Project Manager to the Audit Director² and through command channels. Auditors should first attempt to resolve the situation through the command audit liaison. If access is not granted, the responsible Assistant Auditor General will decide on the appropriate course of action. If deemed appropriate, the responsible Assistant Auditor General will notify the Assistant Auditor General for Strategic Sourcing and Resources Management of a denial situation and simultaneously notify the commander of the activity denying access, in writing, of the Naval Audit Service's intent to notify the Secretary of the Navy, if necessary. If after 15 workdays resolution has not been achieved, the Assistant Auditor General for Strategic Sourcing and Resources Management will elevate the issue to the Secretary of the Navy, via the Auditor General, for resolution. Only the Secretary or Under Secretary of the Navy may deny access to Naval Audit Service auditors. Such denials should only be for National security reasons. If the Auditor General is denied access by the Secretary or Under Secretary for reasons that are unacceptable, adjudication must be requested from the Department of Defense Inspector General within 15 workdays of the denial decision.

3. Privacy Act. The Privacy Act established rights of individuals regarding personal information, records, and privacy. Criminal penalties exist for personnel who knowingly and willfully make unauthorized disclosures of information from an agency's records about individuals. [Secretary of the Navy Instruction 5211.5 \(Series\) \(Department of the Navy Privacy Act Program\)](#) provides for access to personnel records by the Auditor General's representatives in the discharge of their official duties on a "need- to-know" basis. Auditors must consult with the Naval Audit Service legal counsel before requesting access to Confidential Financial Disclosure Reports (OGE 450). Auditors will be particularly careful in extracting and protecting data from personnel and medical records. Normally, published audit reports are not to identify individuals or companies by name. Related working papers containing such details must be safeguarded. Handling of personal and proprietary information is discussed in paragraph [512.2](#).

¹ *The Project Manager is the first-level supervisor who provides day to day audit direction, is most knowledgeable of the ongoing audit, and most likely to present all briefings to senior Department of the Navy managers.*

² *Audit Directors are those individuals who provide general reviews of working papers prepared by the audit team on a continuing basis with emphasis on work performed by the Project Manager.*

CHAPTER 2**QUALITY CONTROL PROGRAM****Contents of Chapter 2**

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201-- PURPOSE

The Naval Audit Service (NAVAUDSVC) Quality Control Program (the Program) includes internal and external quality control checks and reviews, and a Command Inspection Program. The Program is designed to ensure that Department of the Navy (DON) audits, both internal and external, are performed efficiently and effectively, and in compliance with applicable Generally Accepted Government Auditing Standards (GAGAS).

202 -- GENERAL POLICY

1. Assistant Auditor Generals, Audit Directors, Project Managers, and editors will perform quality control checks throughout the audit process to ensure audit policies and procedures are followed.
2. Independent, internal quality control reviews of selected audits or segments of audits will be conducted to provide reasonable assurance NAVAUDSVC policies and procedures are being followed and are in accordance with GAGAS.
3. External quality control reviews will be performed of DON local audit functions, nonappropriated fund instrumentalities, and military exchange audit organizations to ensure these organizations adhere to DON audit policy and operate in an efficient and effective manner. The scope, objective(s), and audit program for external quality control reviews will be tailored for specific situations.
4. Internal and external quality control reviews will be performed in accordance with GAGAS and the Naval Audit Handbook. When doing work related to a local audit function, [NAVAUDSVC P-7511.3 \(Series\) \(Local Audit Function Policies and Standards\)](#) applies.

5. Quality control review results will be documented and recommendations tracked through to final resolution.
6. The Department of Defense Inspector General, the General Accounting Office, or other audit agencies will perform external quality control reviews of the NAVAUDSVC.
7. At a minimum, pre-award and pre-acceptance reviews will be performed on audit services acquired under DON contracts to ensure such services conform to GAGAS and satisfy contractual requirements.

203 – OVERVIEW

1. Internal quality control. *Internal quality control is an integral part of the production process that determines whether audit work meets Generally Accepted Government Auditing Standards (GAGAS) as implemented by the Naval Audit Service, and at the same time evaluates the adequacy of those policies and procedures established by the Naval Audit Service.* Examples of quality control in the Naval Audit Service are:

- An Assistant Auditor General performing key leadership and management functions to ensure standards, policies and procedures are followed (paragraph [307](#) applies).
- An Audit Director, Project Manager, and/or designated senior auditor reviewing the work of a subordinate (paragraph [510](#) applies).
- An editor reviewing draft and final reports for compliance with reporting standards (paragraph [854](#) applies).
- A referencing validation performed by an independent auditor (paragraph [511](#) applies).
- Pre-utilization and pre-publication reviews performed by an Audit Director and Assistant Auditor General.
- A quality control review team evaluating aspects of the audit and reporting processes.
- An auditor performing pre-award and pre-acceptance reviews of contracted audit services.
- An auditor using Internet research capabilities and the Audit Skills/Functional Area Knowledge Database and consulting with other auditors and specialists to resolve accounting, auditing, Information Technology, or other technical issues.

2. External quality control reviews. *An external quality control review is an evaluation by a source external to the activity being reviewed to ensure a quality control program is in place and audit work meets established auditing standards.*

- a. Naval Audit Service performs external quality control reviews of Department of the Navy local audit functions, nonappropriated fund instrumentalities, and military exchange audit organizations. Scheduled reviews are included in the Annual Audit Plan. To avoid unnecessary duplication, auditors should consider and, when appropriate, rely on oversight reviews of these organizations by the Department of Defense Inspector General, and occasional reviews by the General Accounting Office or other audit agencies, to help satisfy the external quality control requirements of the Naval Audit Service.
- b. Quality control reviews of our audits conducted by the Department of Defense Inspector General, the General Accounting Office, other audit agencies, or public accounting firms meet the requirement for external quality control reviews of Naval Audit Service.
- c. In accordance with guidance in [Secretary of the Navy Instruction \(SECNAVINST\) 7510.7 \(Series\) \(DON Internal Audit\)](#) and [Department of Defense Directive 7600.2 \(Audit Policies\)](#), NAVAUDSVC is responsible for quality control reviews of audit services provided under DON contracts, including reviews of Performance Work Statements and contract deliverables.
 - (1) For contracts awarded on behalf of the Naval Audit Service, an Audit Director and Project Manager will be assigned to develop contract documents and monitor contractor work (paragraph [305.1.c](#) applies).
 - (2) For audit services contracts awarded by other DON activities, a Project Manager will be assigned to monitor contractor work in accordance with [SECNAVINST 7510.7 \(Series\) \(DON Internal Audit\)](#).

204 – RESPONSIBILITIES OF ASSISTANT AUDITOR GENERAL FOR STRATEGIC SOURCING AND RESOURCES MANAGEMENT

Assistant Auditor General (AAG) for Strategic Sourcing and Resources Management responsibilities for quality control are:

- 1. Establish, communicate, and maintain quality control policies and procedures that provide reasonable assurance that audit policies and procedures are understood.
- 2. Develop, maintain, or approve objectives and related guidance to be used or adapted in conducting, documenting, and reporting on quality control reviews of published audits.
- 3. Work with the other AAGs to develop an internal quality control review schedule designed to provide reasonable coverage of all aspects of the audit and reporting processes (e.g., staff qualifications, independence, audit performance) at least once every 3 years.
- 4. Designate/approve senior personnel to conduct internal quality control reviews. Designated Project Managers and staff for these reviews should possess expertise and background at the

GS-14 level or above or should have functioned as an audit Project Manager in the past. The Policy and Oversight Division must approve exceptions.

5. Ensure that documentation in the form of working papers ([Chapter 5](#) applies) is retained to support the results of quality control reviews. Working papers will be maintained for 3 years after publication of the quality control review report. Except for the quality control review working papers retained within the Policy and Oversight Division, all other documentation (e.g., the audit report(s) reviewed and related working paper files) will be retained by the affected AAG(s) and disposed of in the normal fashion.
6. At the conclusion of each quality control review, prepare/approve and issue a draft report and subsequently, a final report, to the affected AAG(s).
7. Track recommendations made as a result of quality control reviews until satisfactory evidence of corrective actions has been received or other disposition is agreed to. Followup reviews on selected recommendations may be made.
8. Based on results of quality control reviews, determine the need for modifications to audit policies and procedures and make the necessary changes.
9. Ensure that the Naval Audit Handbook and other Naval Audit Service policies are sufficiently up to date and in compliance with General Accounting Office and Department of Defense audit policies and procedures.
10. Review audit policy implementation procedures issued by AAGs to ensure they are reasonably consistent with Naval Audit Service audit policies and procedures.
11. Monitor data in the management information system to identify problems warranting review, such as: chronic delays in completing assignments; numerous/unexplained audit suspensions; chronic failure to submit timely/adequate documentation to support the Annual Audit Plan; and numerous/unexplained curtailments of audits at completion of survey.

205 – COMMAND INSPECTION AND MANAGEMENT CONTROL PROGRAMS

The Naval Audit Service Command Inspection Program, which is part of the larger Quality Control Program, is used to ensure that the Naval Audit Service's personnel management and administrative policies and procedures, as detailed in the [Naval Audit Management Handbook](#), are complied with and that operations are carried out efficiently and effectively. The Quality Control Program is, in turn, a major component of the Naval Audit Service's Management Control Program that is designed to identify and correct material internal control weaknesses.

CHAPTER 3**AUDIT PLANNING AND
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PART I -- PLAN DEVELOPMENT

301 -- GENERAL POLICY

The Secretary of the Navy (SECNAV) is responsible for ensuring adequate internal audit coverage within Department of the Navy (DON) programs and operations. In January 1998, SECNAV issued guidance that details the responsibilities of DON management in audit planning and charters a senior level Audit Planning Group (APG) to assist the Auditor General of the Navy (AUDGEN) in recommending audit plans and priorities to the SECNAV. The [planning Charter](#) requires submission of audit plans for the next two years to the APG six months prior to the end of each fiscal year. Consistent with the Charter, the Naval Audit Service's mission is to provide independent and objective audit services to assist Naval leadership in assessing risk to improve efficiency, accountability, and program effectiveness.

The following general policies apply to the development of the Department of the Navy Internal Audit Plan (the Plan).

1. Audit research will be used to identify and prioritize: (a) significant DON institutional and programmatic vulnerabilities and related risks through a process of risk assessment and (b) potential audit topics that include audit objectives and potential benefits. Research will also estimate required resources (personnel and travel costs) for both near-term and long-term potential audit topics. Research should address what work we should be doing not just what we have resources to do. For example, the audit universe should not be limited to those risks that correspond to current in-house skill sets.
2. As a general rule, the Plan will place emphasis on audits that address significant vulnerabilities and related risks that are closely aligned with the strategic goals of the DON (including verification of data related to performance goals), and those that are required by law or directive. In addition, the Plan will include resources for audits, advisory services, and assistance that respond to concerns of management including, not only APG members, but also DODIG, Navy IG, NCIS, Fleet Commanders, SYSCOM Commanders, DONCIO, etc.
3. The Plan will also contain information on our ongoing projects; and planned audits for activities that have an internal audit staff and for nonappropriated fund audit staffs.
4. Documentation will be kept that supports the results of general research. At a minimum, documentation will include completed [Project Planning Worksheets \(PPWs\)](#) for proposed near-term audits.

302 -- DEFINITIONS

1. Audit planning, in the largest sense, is an overall strategy to identify the areas, functional or organizational, where we will conduct vulnerability assessments, risk assessments, and relevant audits. The areas where we focus our vulnerability and risk assessment efforts are based on **factors related to the achievement of the DON's mission and goals** including:

- Importance to warfighting capability/readiness
- Congressional/DOD/media emphasis
- Management control importance (inherent risk/exposure/potential impact)
- New programs/systems and extent of recent program/system change

Our research and resultant executive decisions on these matters should identify the most significant issue areas where we can do the most for the DON by analyzing vulnerabilities and related risks. Within each issue area, we will further identify DON's most significant institutional and programmatic vulnerabilities and related risks and, where feasible, schedule and efficiently execute those audits that will best mitigate the identified risks. Our goal is to target the riskiest parts of the riskiest areas.

2. Vulnerability suggests that there are conditions present which may keep the DON from fully meeting its mission or strategic goals. ***A vulnerability is an overarching shortfall, condition, method of doing business, control approach, or immutable reality.*** It isn't always possible to eliminate a vulnerability in the near to mid-term. An example in the financial area would be the lack of a double-entry accounting system that meets Government accounting standards. An example in the readiness area is the fact that the combat unit commanders responsible for readiness are also responsible for judging and reporting the results they have achieved. In these cases, the time, costs, and institutional changes required to eliminate these vulnerabilities are so extensive that it is impossible to eliminate these aspects of reality in the near to mid-term.

3. Vulnerability, when dissected, will identify one or more areas of risk that may need to be analyzed and addressed through a process of risk assessment. ***Risk is a concept used to express the extent of uncertainty about events and/or their outcomes that could have a material affect on the DON's mission or strategic goals. Risk results from any course of action or inaction as an organization pursues its goals/objectives. Risk assessment is the identification of risk, the measurement of risk, and the process of prioritizing risks.*** NAVAUDSVC helps the DON be less vulnerable in a given issue area by identifying significant potential risks and, where feasible, by planning audits to defuse the possibility of an adverse occurrence. NAVAUDSVC can reduce overall DON vulnerability by creating an environment supportive of identifying and mitigating risks.

303-- PLANNING PROCESS

The Department of the Navy Internal Audit Plan (NAVAUDSVC P- 7511.1) informs DON activities and commands of audits the Naval Audit Service either plans to begin or will have in progress during the next two fiscal years. The Plan provides coverage that supports the DON's efforts to achieve its strategic management performance goals and addresses significant institutional and programmatic vulnerabilities and related risks in the most important issue areas. Specific audits assess program performance, economy and efficiency of operations, financial operations, and/or internal controls. The Plan also includes audits for activities that have an internal audit staff and for nonappropriated fund audit staffs. Potential audit topics will be generated on a continuous basis by: vulnerability/risk assessment results, DON management

requests, DOD Joint Planning Groups, Naval Audit Service personnel, and the audit follow-up system.

1. Audit Planning Group. The [APG](#) is chaired by the AUDGEN, and includes senior representatives of the Under Secretary, General Counsel, Assistant Secretaries, Chief of Naval Operations, and Commandant of the Marine Corps. The APG provides advice and assistance to the AUDGEN in the following areas: (a) DON's most important issue areas and the related significant institutional and programmatic vulnerabilities and risks identified and the degree to which audits outlined in the Plan address those vulnerabilities and risks, (b) prioritization of audits to more closely align expenditure of scarce audit resources with the strategic goals of the DON, and (c) an estimate of the residual risks associated with the plan. On an ongoing basis, the APG will provide: (a) advice and counsel to the AUDGEN regarding audit planning, programming and budgeting, (b) input on proposed revisions to the audit plan, and (c) input on proposals to terminate audits previously coordinated with principal members of the APG.

2. Assistant Auditor General responsibilities.

- a. In conjunction with DON management, the Assistant Auditor Generals (AAGs) for the audit execution directorates, working in a collaborative and cooperative fashion with each other, are responsible for: (1) contributing to the corporate planning process by identifying issue areas for vulnerability and risk assessment, (2) identifying the most significant institutional and programmatic vulnerabilities and related risks within their assigned issue areas, (3) ensuring that audits are planned to address the most significant vulnerabilities and related risks on a corporate basis (as opposed to an issue area basis) with an appropriate combination of in-house and contract resources, and (4) identifying the additional resources needed to address the remaining identified, significant vulnerabilities and related risks (i.e., the residual risks).
- b. Effective planning requires that proposed near-term audits (i.e., those proposed for the next fiscal year or as add-ons to the current fiscal year) be supported by [Project Planning Worksheets \(PPWs\)](#). As a general rule, these PPWs should be coordinated with responsible APG members. PPWs should be developed with limited expenditure of audit resources, prepared using the PPW Format, and forwarded to the Planning Division in a timely fashion for input to the planning database. After a PPW is included in the Plan, the cognizant AAG is responsible for updating the PPW to reflect material changes in conditions affecting the PPW until the audit is executed.

3. Audit research process.

- a. **Description.** *Audit research is the process of obtaining accurate and relevant information concerning significant DON issue areas and related institutional and programmatic vulnerabilities; identifying, measuring, and prioritizing the related risks through a process of risk assessment; and identifying and prioritizing related potential audit topics.* Each AAG will be allocated resources consistent with their identified research requirements. As part of their collective effort to identify the DON's most important goals and the major risks to achieving those goals, AAGs should interview the DON's senior management officials and evaluate: (1) the Quadrennial Defense Review

(DOD Strategic Plan); (2) Joint Chiefs of Staff planning documents (e.g., National Military Strategy, Joint Vision 2010); (3) DOD, DON, Major Command, and Subordinate Command planning documents (e.g., DOD Logistics Strategic Plan, DOD Information Technology Management Strategic Plan, Navy Posture Statement); (4) DON's Business Vision and Goals; (5) DON's Strategic Plans and Goals; (6) the National Defense Authorization Act; (7) the Future Years Defense Plan; (8) General Accounting Office Performance and Accountability and High-Risk Series Reports; and (8) other such guidance. *To the extent practicable, the research process will be detailed enough to adequately identify the most significant institutional and/or programmatic vulnerabilities and related risks; what activities, if any, are under way to mitigate those risks; and the potential costs and benefits of specific proposed audits.* If a specific audit is proposed for inclusion in the Plan, audit research should identify the resources required and the audit objective(s), audit scope, and background information needed to provide a perspective on the nature and significance of the proposed audit and the manner in which it will mitigate identified risks. A [PPW](#) detailing this information will be provided to the Planning Division for each proposed near-term audit (next fiscal year and add-ons to current fiscal year).

- b. Notification.** As a general rule, the responsible AAG will send a research announcement letter to responsible DON managers with a copy to the Planning Division. Although general research numbers are provided to each Directorate each year, sub numbers can be assigned in DAMIS to avoid confusion where different commands/projects are involved.
- c. Research entrance conference.** If an entrance conference is necessary, the audit manager of the audit research process should inform management officials how general research is used to identify significant vulnerabilities and related risks and to plan audit coverage. It is important that management understand that research is not the same as audit.
- d. Limited scope audit.** Disclosure of a material or sensitive issue during audit research may result in a limited-scope audit. Upon approval by the AAG, the Audit Director (AD) will notify DON officials of the limited-scope audit. A [PPW](#) will be prepared and provided to the Planning Division for input to the planning database. Before making a final decision to do a limited-scope audit, the AAG may need to consider tradeoffs against audits in the Plan that may not start as planned. The risk assessment/prioritization process will aid in making this decision. In addition, the AAG, or his representative, may decide to consult with one or more members of the APG as part of the decision-making process.

4. Strategic Sourcing and Resources Management Directorate responsibilities.

- a. The Plan.** The Strategic Sourcing and Resources Management (SR) Directorate will develop a draft Plan on or about 31 March of each year. Two versions of the Plan are prepared as follows:
 - (1) External version.** The AUDGEN signs the final external version of the two-year Plan. For each audit the Naval Audit Service plans to start in the first (next) fiscal year and for those audits in-process from the previous (current) fiscal year, the Plan

will list the title, objective(s), reason for coverage (including an identification of vulnerabilities and related risks), estimated start date, and estimated completion date. For audits in-process, the Plan will also include the estimated report publication dates. For workload tentatively planned for the second fiscal year, the Plan will include more limited information. The Plan will also include audits planned by DON commands with a local audit function and DON non-appropriated fund audit staffs. The external version of the Plan will be finalized on or about 30 September of each year and distributed to DON commands and activities, Department of Defense internal audit organizations, and the General Accounting Office.

(2) Internal version. An internal version of the Plan will be distributed within the Naval Audit Service and to APG members. The Plan will be in priority order by issue area. It will include information included in the external version as well as the resources allocated to each audit planned for the first (next) fiscal year.

b. Corporate planning. Based primarily on input from the AAGs and with their assistance, the SR Directorate will help ensure that the Audit Plan addresses the DON's highest risks while at the same time providing appropriate, minimal coverage of all major issue areas. Issue area and/or staff assignments should change as the identified, significant vulnerabilities, related risks, and priorities change. When appropriate, the SR Directorate will recommend that issue areas and/or staff be allocated/reallocated among AAGs to address the most significant vulnerabilities and highest risk areas. Generally, for span of control purposes, the AAGs should be assigned about the same size staff. The SR Directorate will also work closely with the AUDGEN/DEPAUDGEN and the AAGs to determine how best to address the high priority residual risks identified by the AAGs (e.g., additional contract resources, additional in-house skill sets, staff increase).

PART II -- PLAN IMPLEMENTATION

304 -- AUDIT ANNOUNCEMENTS

1. Before beginning an audit project, the responsible AAG must send an announcement letter to the management officials to be audited, to superiors in the chain of command and to other interested parties ([Format](#) and [Contents](#) guidance is provided in the linked documents). The objectives in the audit announcement letter should be as stated in the Plan. **If the announced objectives are changed during the audit, the audit will be re-announced, citing the revised audit objectives.** Copies of audit announcement letters will be provided to the General Accounting Office, the Department of Defense Inspector General for Auditing, and the Naval Criminal Investigative Service. **Audit managers are responsible for consulting with the auditee(s) and determining distribution requirements beyond the minimum defined in the ["Report/Announcement Letter Distribution and Coordination List."](#)** The [Naval Audit Service Audit Liaison Directory](#) is designed to assist the auditors in making this determination. Both of these documents are kept up-to-date with the assistance of the field auditors. AAGs should post initial and revised announcement letters to the "O" Drive so they can, in turn, be posted to the WEB Site.

2. Unannounced disbursing audits will not be formally announced in advance of the planned start date. Advice of such audits will be hand-delivered at the start of the audit. On all other audit efforts, the responsible AAG should generally provide 30-day written notifications. When 30-day written notifications cannot be given (such as with audit research efforts, limited-scope audits, or time sensitive issues), the AAG will ensure that notification is given *as far in advance as possible* prior to staff visits.

305 – OVERSIGHT, CHANGES, SUSPENSIONS, AND CURTAILMENTS

1. Responsibilities.

- a. AAGs are responsible for executing the Plan. They must have their staff coordinate with the General Accounting Office and other audit, investigation, and inspection organizations to avoid duplication of audit coverage. Assigned auditors must contact the Naval Criminal Investigative Service to determine whether the command has any ongoing interest in the subject audit, within the scope of the audit.
- b. AAGs must ensure that each audit for which they are responsible is properly planned, performed in accordance with Naval Audit Service policies and procedures, and completed within reasonably established timeframes that accommodate management's needs.
- c. For audits that will be performed by a contractor on behalf of the Naval Audit Service, an Audit Director (AD) and Project Manager (PM) will be assigned to develop contract documents and monitor contractor work. **An audit number will be assigned to each contract audit and all associated in-house effort will be charged to that single audit number.** Procedures for “opening” contract audits are discussed in paragraph [404](#). The AD and PM will perform the following specific functions:
 - Preaward actions such as: Develop a Performance Work Statement, Technical Evaluation Plan, Government Cost Estimate, and Contractor Quality Control Program.
 - Evaluate bid proposals and contractor oral presentations, and select the “best value” bidder.
 - Prior to contract solicitation, determine contract security requirements.
 - Coordinate contract solicitation and pre and post award actions in conjunction with the Strategic Sourcing and Resources Management Directorate.
 - Monitor the progress of the auditors under contract.
 - Provide technical guidance as needed.
 - Review and accept contract deliverables to include audit plans, audit programs, summary working papers, and draft and final reports.

- Ensure DON management actions planned or taken as a result of recommendations made by contracted auditors are acceptable. A copy of each final report should be provided to the Strategic Sourcing and Resources Management Directorate for input into the followup system.
- Remain involved in the resolution process for “undecided” recommendations.
- Report contractor noncompliance/performance problems to the Contracting Officer for resolution.

Detailed guidance on responsibilities of the AD and PM is included in the [Naval Audit Service Procedures Manual \(Contracting for Audit Services\) dated 14 May 1999](#).

- d. A draft report will be edited and independently referenced to the degree specified (i.e., “selectively”) before it is submitted to the auditee. Information copies will be provided to two echelons above the auditee(s) but no higher than the ASN level.

2. Changes to the Annual Audit Plan. Audit objectives and resource estimates included in the Plan may be adjusted, as necessary, for unforeseen events. AAGs are responsible for explaining Plan changes to the APG. Often, this will be done after the fact when we explain performance against the plan.

- a. **New audits.** The Annual Audit Plan is sufficiently flexible to allow revisions for priority audit requirements that are self-initiated or requested by management. AAGs can add audits to the Plan at their discretion after assessing risks and priority and after considering whether the work would be more appropriately accommodated by the Naval Inspector General, NCIS, DODIG, contractors, or someone else. The AUDGEN/DEPAUDGEN will be advised of the nature and dispensation of any requests from Secretariat offices and senior Department of the Navy commands (Echelons 1 and 2). For information purposes, the AAG will: (1) provide a [PPW](#) to the Planning Division with objective(s) and scope, staff hours, calendar days, and travel dollars, and (2) identify known impact(s) on the current Plan. The Planning Division will use the information to update the planning database.
- b. **Survey Debriefs.** AAGs will ensure that Survey Debriefs consider all impacts to the Plan, and will update DAMIS to show approvals of Survey Debriefs.
- c. **Audit Director Responsibility.** The Audit Director (AD) is responsible for controlling and monitoring audit work and preparing the final report. The AD will continually reevaluate the need for programmed or additional resources -- that is, hours, travel dollars, and calendar days. When the AD recognizes the need for adjustments, the applicable AAG will be advised. The AD should indicate the impact of the requested change on participating auditors and the audit as a whole. Approval of requests for additional resources and associated impact statement(s) are the AAG’s responsibility. After approval, the AD will update DAMIS to show the decision.

3. Audit suspensions. Audit suspensions must be minimized due to the loss of work continuity and information obsolescence. If the assigned staff is insufficient to efficiently maintain reasonable progress, an audit should be suspended. AAGs have authority to initiate or approve audit suspensions. If the AAG initiates or approves a suspension, the AD should update DAMIS to show the reason, the impact(s), and other relevant information including the suspension start date and anticipated restart date. When a suspension is expected to exceed 60 calendar days, the AAG will notify, in writing, the activities or commands that received a copy of the audit announcement letter. A copy of this notification will be retained in the working papers and a copy will be provided to the Planning Division.

4. Audit curtailments. AAGs have the authority to initiate or approve audit curtailments. A curtailment letter is appropriate when insufficient audit work was performed to complete any announced objectives. A formal report (standard or letter format) is required when one or more announced objectives of an audit has been completed. An AD's request to curtail an audit must be submitted *in writing* to the applicable AAG for approval. The request from the AD must provide sufficient justification for an informed judgement by the AAG. Either the AAG or AD will document the decision by the AAG. The AD will include the decision paper in the audit working papers. A decision to curtail an audit must be communicated in writing to all addressees of the audit announcement letter with an information copy to the Planning Division. A copy of this notification will also be filed in the audit working papers. An audit number is not assigned to an audit that is curtailed.

PART III -- AUDIT EXECUTION

306 -- STRATEGIC SOURCING AND RESOURCES MANAGEMENT DIRECTORATE

Planning Division. The following are the responsibilities of the SR Directorate.

- Oversee the accuracy of DAMIS and point out noted problems to AAGs.
- Maintain a repository of [Project Planning Worksheets \(PPWs\)](#).
- Track ongoing and planned audits as part of preparation for APG meetings and to apprise the AAGs of any duplication within the Plan.
- Coordinate and participate in APG meetings.
- Serve as focal point for questions concerning the Plan.
- Provide copies of GAO and DODIG announcement letters to applicable AAG.

307 – ASSISTANT AUDITOR GENERALS

With appropriate support from subordinate staff members, Assistant Auditor Generals (AAGs) of operational (audit execution) directorates are responsible for supporting corporate goals and for

all research and audit projects within their respective areas. This responsibility includes, but is not necessarily limited to, the following key leadership and management functions:

- 1.** Collaborating and cooperating with each other and the SR Directorate to corporately assess and prioritize risks and to allocate staff and workload to address the DON's greatest identified needs within available resources.
- 2.** Identifying residual risks (i.e., unfunded, potential audits), and resources required to address such risks as part of the corporate planning process (paragraph [303.4.b](#) applies).
- 3.** Ensuring that for each audit/research project undertaken, resources are sufficient to complete the project in a timely manner consistent with customer needs and in accordance with Naval Audit Service policies and procedures.
- 4.** Participating in appropriate meetings with senior DOD and DON leaders and managers (e.g., planning meetings with APG members, audit conferences with senior leaders of audited commands, and DOD Joint Planning Group meetings).
- 5.** Keeping DAMIS current for assigned projects.
- 6.** Delivering quality/timely/cost effective results for each assigned research and audit project by taking actions such as:
 - a.** Planning and controlling assignment and release of audit staff members to prevent excessive staffing and to maximize the benefits of on-the-job training (OJT) (related OJT guidance was provided by the Auditor General in the document entitled "[Development of Entry Level Personnel](#)"). Optional "[Audit Assignment Considerations](#)" are provided in the linked document.
 - b.** Identifying the need and acquiring technical experts in a timely manner (paragraph [309.3](#) applies).
 - c.** Ensuring that audit and research efforts remain properly focused on approved objectives.
 - d.** Keeping AUDGEN/DEPAUDGEN and other DON officials appropriately informed of audit and research progress and results. The AUDGEN provided guidelines for "[Status Briefings of all Research, Survey, Audits and Other Products](#)" in the linked document.
 - e.** Apprising AUDGEN/DEPAUDGEN of sensitive issues.
 - f.** Making sure audit reports are properly edited (paragraphs [854](#) and [857](#) apply) and independently referenced (paragraph [511](#) applies) to the degree specified (i.e., "selectively") prior to utilization and that supporting working papers comply with guidance in [Chapter 5](#).

- g. When necessary to ensure timely reporting, publishing final audit reports without command comments after informing the AUDGEN/DEPAUDGEN. Paragraph [618.3f](#) contains further information on publishing without comments.

308 -- COMMERCIAL ACTIVITY REVIEWS

1. Department of the Navy activities are required to estimate and compare the costs of performing commercial-type functions in-house and by contract. The Office of Management and Budget requires that the in-house bid be reviewed and certified by an Independent Review Officer (IRO) before the bid can be accepted by the Contracting Officer for comparison to the contract bid. The Department of the Navy has elected to have independent reviews performed under contract with the Naval Audit Service providing contractor oversight and ultimately signing the IRO certification for Navy CA studies with 41 or more announced civilian billets and for Marine Corps studies with 51 or more announced civilian billets. For each review, the Naval Audit Service's stated objective is to obtain assurance that work performed by the Independent Review Officer Support Contractor provides a reasonable basis to certify that:
 - a. The management plan establishes the government's ability to perform the Performance Work Statement within the resources provided by the Most Efficient Organization; and
 - b. All costs in the In-house Cost Estimate were prepared in accordance with the procedures and requirements of [OMB Circular A-76](#), its [Supplemental Handbook](#), and [OPNAVINST 4860.7C](#) or [MCO 4860.3D](#).
2. Due to the sensitive nature of Commercial Activity information, all personnel must exercise a high degree of care over handling, storing and using such data. Distribution of certifications, summaries or data relating to a Commercial Activity Review will be limited to those who have a need to know. Additional guidance is provided in the [Naval Audit Service Guide for Reviewing Cost Estimates Prepared Under the Commercial Activity Program](#) and in the [Commercial Activity Study Independent Review Process Guide](#).
3. Commands must notify the Naval Audit Service of the need for a review at least 30 days prior to the requested review start date. An example request letter is available on both the [Navy](#) and [Marine Corps Commercial Activity Web Pages](#).

309 -- AUDIT AND TECHNICAL ASSISTANCE

1. **Providing assistance.** As in all audit work, staff assigned to assist work will possess adequate professional proficiency, exercise due professional care, be properly supervised, and process audit results in accordance with the reporting requirements of this Handbook.
 - a. **Non-DOD or non-Government entities.** The SR Directorate will coordinate assists for non-DOD or non-Government entities. Audit assistance will only be provided after approval of the AUDGEN/DEPAUDGEN.

- b. **Other DOD audit organizations or investigative agencies.** Requests for our audit assistance from other DOD audit organizations or investigative agencies may be accommodated at the discretion of the cognizant AAG after assessing the risk/priority of the work and the availability of staff and other resources. DODIG sponsored Joint Planning Group meetings and Navy IG/NCIS/NAS joint planning efforts may produce audit assist agreements and arrangements. Audit findings, DON data, and/or copies of working papers generated as a result of an assist effort will not be released outside DON until utilization has been completed with responsible DON command(s). Unless otherwise directed by the AUDGEN, original working papers will be retained by the AAG.

2. Requesting audit assistance.

- a. **DODIG.** Interface and coordination with the DODIG will be in accordance with [subparagraph d](#) or as arranged as a consequence of DOD Joint Planning Group participation.
- b. **Defense Contract Audit Agency.** The Naval Audit Service is responsible for auditing procurement and contract administration functions performed by Naval activities. However, access to contractors' records normally will be through the Defense Contract Audit Agency. The need for Defense Contract Audit Agency assistance and reports should be considered during audits of such activities as the Naval Sea Systems Command; Supervisors of Shipbuilding, Conversion, and Repair; and Engineering Field Divisions or Officers in Charge of Construction for the Naval Facilities Engineering Command. Requests for such assistance will be submitted in writing by the AAG and will identify the objective and scope of the audit.
 - (1) The request should advise the Defense Contract Audit Agency of the audit and should request that the responsible local agency office provide audit assistance. The request should also provide enough information for the agency auditor to fully understand the purpose, scope, and objective of the audit and the date the requested information is needed. This will enable the auditor to determine audit effort required and the availability of audit resources. The Defense Contract Audit Agency is required to confirm receipt of all requests in writing within 7 working days.
 - (2) If the agency is unable to render requested assistance within the specified timeframe or a timeframe mutually acceptable to both the Defense Contract Audit Agency and the Naval Audit Service, alternative arrangements may be considered that will permit Naval Audit Service auditors to review contractors' books and records. In such cases, the AAG may request the Defense Contract Audit Agency to make the necessary administrative arrangements for Naval Audit Service access to those contractor records needed to complete an audit. Prior to visiting a contractor facility in connection with one or more Government contracts, the auditor must provide the contract administration office with a list of the contractor data or information that is needed for audit purposes. This information will be furnished in accordance with the [Federal Acquisition Regulation 42.402](#). If such information has been recently

- reviewed by or is available to another Government auditor, our auditor will be referred to that other Government auditor.
- (3) To maintain consistency within the Department of Defense in auditing contractor records, the guidelines set forth in the [Defense Contract Audit Agency Audit Manual](#) will be followed.
 - (4) If problems develop in obtaining access to contractor records, the responsible AAG will coordinate with the SR Directorate, if deemed appropriate.
 - (5) The Assistant Inspector General for Policy and Oversight, Office of the Inspector General, Department of Defense, is the focal point for resolving any disputes between the Naval Audit Service and the Defense Contract Audit Agency. The SR Directorate will be informed of all contacts concerning disputes between the Defense Contract Audit Agency and the Naval Audit Service.
- c. Other Non-Department of the Navy activities.** Access to information or audit work at Non-Department of the Navy activities, such as the Defense Finance and Accounting Service (DFAS), will be initiated and coordinated by the responsible Assistant Auditor General. All audit work required at any Defense Agency will be coordinated through the Assistant Inspector General for Auditing, Audit Planning and Technical Support DOD. The linked document entitled "[Report/Announcement Letter Distribution and Coordination List](#)", Section C, provides guidelines regarding coordination.
- (1) Requests for access to DFAS organizations should be in writing and should include a job order number, a copy of the announcement letter, and locations to be visited. Information gathering at any Defense Finance and Accounting Service Center will be coordinated as stated above. Information gathering at any DFAS local finance and accounting office will be coordinated through the DFAS representative at the responsible Center after providing a copy of the announcement letter to DFAS Headquarters. When information from the Defense Logistics Agency (DLA) is needed, the responsible Assistant Auditor General will coordinate directly with DLA Headquarters, Internal Review Division, Code DLA-CI.
 - (2) Written requests for audit work must be as specific as possible to ensure that we receive exactly what we need. At least 30 days prior to the desired start date of the work, provide the Assistant Inspector General for Auditing, Followup, and Technical Support, DOD the following:
 - Purpose
 - Scope
 - Objectives
 - Locations to be visited
 - The date the information or results are required

- Specific information or assistance required; e.g., an audit program or detailed description of steps
 - Any pertinent information concerning the work required
- (3) Any matter that cannot be resolved between the Naval Audit Service and the Assistant Inspector General for Auditing, Followup, and Technical Support, DOD will be promptly referred to the Inspector General, Department of Defense, for resolution.
- (4) Requests for information from contractors should be coordinated with legal counsel. A determination must be made as to the need for reimbursement for the information requested.
- d. **Other audit organizations.** Whenever assistance from another audit organization is required, the AAG will arrange for it. The AAG will sign out a formal request for assistance at least 30 days prior to the date the assistance is needed. The formal request will identify the purpose, scope, and objectives of the desired assistance.
- e. **Computerized Matching Programs.** Use of computerized matching programs to detect fraud or related improprieties requires Chief of Naval Operations notification 90 days before a matching program can be initiated outside the Department of the Navy. An AAG's request to use computerized matching programs must be coordinated with legal counsel, at least 90 days prior to the date of the anticipated matching procedure. Preliminary telephone contact with the legal counsel is encouraged to define information required for Chief of Naval Operations notification.
- 3. Obtaining technical assistance.** Effective use of technical experts enhances the credibility and quality of audit products and minimizes resources and time needed to accomplish audit objectives. Audit teams should include adequate technical proficiency for the tasks required. Reviews that include large numbers of items to be examined or highly technical issues to be assessed may require technical experts. AAG's should identify the need for technical assistance as early as possible so as to allow sufficient lead-time to identify and acquire the required skills.
- a. Information and assistance on computer extractions, simulations, or matching may be available from the SR Directorate. Technical expertise in other areas, such as: statistical sampling, medical, civil engineering, legal, and procurement may also be available from within the Naval Audit Service. If needed expertise is not available in-house, the SR Directorate may help in obtaining assistance from outside sources including other DON commands, the Department of Defense Inspector General, other Service agencies, or by contract.
- b. Effective control is required over technical experts while they are assisting the Naval Audit Service. For example, technical experts may not possess knowledge of the requirements associated with generally accepted government auditing standards. Therefore, there must be an agreement concerning: what, specifically, the expert will do; the type of documentation required; how the expert will communicate the review results to the audit organization; with whom in the audit organization the expert shall deal; and

to whom the expert shall report. Consideration must be given to whether the required technical services can be performed on a one-time basis or whether additional support will be required when responding to the auditee's comments and concerns prior to issuance of the final audit report. These aspects normally should be formulated in writing before engaging the expert.

- c. Requests for regulatory interpretations or technical advice from the Assistant Secretaries of the Navy, the Office of Chief of Naval Operations, Commandant of the Marine Corps, the Office of General Counsel, or the Comptroller of the Navy, **must** be approved by the AAG.

310 -- INSPECTION AND COOPERATION

1. Policy. As indicated in [SECNAVINST 5040.3 \(Series\)](#), the Naval Inspector General has responsibility for supervision, guidance, and coordination of inspection within DON. The Naval Audit Service may be requested to provide subject matter experts on inspections.

2. Information exchange. Audit reports are provided on a routine basis to immediate superiors in command, area coordinators, major claimants, and commands with technical responsibility for the Naval Command Inspection Program. Management information is made available to our auditors in accordance with [Secretary of the Navy Instruction 7510.7 \(Series\)](#). Reports of command inspections are included in information available to our auditors. However, the information in inspection reports is privileged and subject to the following restrictions:

- Inspection reports of audited activities/ programs will be made available informally to our auditors.
- Auditor examination of inspection reports is limited to gathering information directly associated with the audit objectives.
- Audit reports will not refer to material, information, or data derived from inspection reports. This does not preclude including findings, developed by audit, which stem from or corroborate information contained in inspection reports.

3. Naval Inspector General. Responses to Inspector General inquiries regarding completed audits must be provided through the SR Directorate.

311 -- OTHER NON-AUDIT ASSISTANCE

1. Other assistance involves providing an auditor's expertise to commands/ programs. In these instances, the command/ program manager provides direction. Requests for other assistance should be directed to the AAG for approval.

2. An auditor assigned to perform other assistance should provide written correspondence summarizing results of the assist work. Depending on the circumstances, such summaries can be in the form of narrative working papers, letters, or memoranda from the assisting auditor (rather

than from the Naval Audit Service) to the requesting official. Regardless of the form of communication used, other assistance is not considered an audit. Information provided must not be on Naval Audit Service letterhead stationery of any type and should not be provided in a format that would appear to be an audit report.

3. A PM should be assigned to each assist.
4. All papers prepared on other assists will be turned over to, and maintained by, the requesting official/ organization.

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PART I -- AUDIT SURVEY

401 -- POLICY

Generally Accepted Government Auditing Standards (GAGAS) related specifically to the survey process include:

- As a general rule, an audit survey shall be performed as part of each audit (paragraph [406.1](#) applies).
- A written survey plan/program is to be prepared early in the survey phase (paragraph [406.2](#) applies).
- An assessment is to be made of applicable internal controls and compliance with applicable laws and regulations when necessary to satisfy the audit objectives (paragraphs [410](#) and [411](#) apply).
- A written audit program is to be prepared based on survey results ([Part III](#) of this Chapter applies).

402 – PURPOSE, RISK, AND MATERIALITY

1. Purpose. The purpose of audit survey is to:

- Gather background information to determine the materiality and risk of a program, system, or function. The optional [Pre-Audit Customer Survey](#) or elements of the survey can be used as part of this process. **The audit survey process helps audit managers identify and selectively audit areas of highest risk.**
- Assess the adequacy and effectiveness of applicable internal controls and compliance with applicable laws and regulations.
- Evaluate actions taken in response to previous audits, inspections, or management/contractor reviews.
- Identify **material** weaknesses and **significant** potential problems.
- **Refine the planned audit objective(s), scope, and completion date.**
- Provide a basis for a decision to curtail the audit or continue into the verification phase.
- Design an audit program to achieve the planned audit objectives.
- Determine resources necessary to perform the audit.

The results of the survey are reported in the Survey Debrief report. The Debrief and related Audit Program provide a road map for pursuing and supporting the audit objective(s) and the scope of audit coverage, which may differ from original plans. The [Institute of Internal Auditors' WEB page](#) provides useful information on the subjects of risk and control.

2. Risk assessment. The purpose of risk assessment is to examine the parts of the auditable unit and design the audit effort to be devoted to each part in proportion to the risk and significance of each part to the overall unit. Business processes that are unimportant, or which have very little risk associated with them, may be excluded from the audit scope or subjected to limited testing. High-risk areas may require more extensive tests, more care and accuracy in sample selection, or more time (or all of these). **As a general rule, the risk assessment process should be used to scope audits so that the survey and verification phases can be completed in 250 days or less. This may mean that some high-risk areas are not covered in the current audit and have to be scheduled for a subsequent audit. On a given audit, our goal is to audit the riskiest parts of the riskiest areas.**

3. Identifying material weaknesses. A primary purpose of the audit survey is to identify material weaknesses in relationship to the audit scope and objective(s) and related high-risk areas.

- a. A material weakness is one that significantly impairs or may impair the ability of an activity, program, or command to fulfill its mission; deprives or may deprive the public of needed services; violates or may violate statutory or regulatory requirements; significantly weakens or may weaken safeguards against waste, loss, unauthorized use or misappropriation of funds, property, or other assets; or results or may result in a conflict of interest.** In effect, a material weakness results from internal controls that are not in place, not used, or not adequate. In determining what has or may significantly or materially affect operations, auditors must consider such factors as the amount of expenditures, the newness of the activity or changes in its condition, the adequacy of internal control systems, the results of prior audits, the level and extent of review or other forms of independent oversight, the expectation of adherence to applicable laws and regulations, and the magnitude of specific problems identified. It is obvious that *no all-inclusive formula or definition can exist to answer the question: "Is this a material weakness?"* Similarly, there can be no master list created against which individual weaknesses can be matched to answer the same question. Professional judgement must be used each time the materiality question arises.
- b.** To help auditors with this decision process, some factors that should be considered when determining whether a weakness is material have been included in paragraph 807. [SECNAV Instruction 5200.35 \(Series\)\(Department of the Navy Management Control Program\)](#) also contains discussion and criteria related to material weaknesses. Optional guidelines for "[Determining Materiality for Financial Statement and Financial-related Audits](#)" are provided in the linked document.

403 – ASSISTANT AUDITOR GENERAL RESPONSIBILITIES

The responsible Assistant Auditor General (AAG) will:

- a. Designate an Audit Director, Program Manager, and necessary staff for survey.
- b. Ensure that the scope and objectives of the survey are limited to that necessary to report significant results. As a general rule, surveys should be completed in 90 days or less. AAGs can tailor the duration and audit hours devoted to the survey based on the audit objectives and the subject matter.
- c. Review and approve any changes to audit objectives included in the Department of the Navy Internal Audit Plan (paragraph [305.2](#) applies).
- d. Ensure a written survey plan/program is prepared early in the survey (paragraph [406.1](#) applies).
- e. Identify the need for assistance, including that of technical experts, and make necessary arrangements (paragraphs [309.2](#) and [309.3](#) apply).
- f. Ensure the Survey Debrief report addresses issues as detailed in [Part II](#) of this Chapter.
- g. Review and approve the survey results (Go or No-Go Decision). Provide written instructions to the responsible Audit Director, with a copy to the Strategic Sourcing and Resources Management Directorate, if a decision is made to curtail an audit after survey (paragraph [305.4](#) applies).
- h. Ensure the Auditor General/Deputy Auditor General are briefed on the survey results (paragraph [307.6d](#) applies).
- i. Ensure the Audit Director/Project Manager participate in end-survey meetings with senior client management.

404 -- SURVEY ENTRANCE CONFERENCE

As discussed in paragraph [304](#), an Audit Announcement letter should be sent to the management officials of the program or activity to be audited and to their superiors in the chain of command. All correspondence should reference the project number included in the Department of the Navy Internal Audit Plan or assigned by the SR Directorate for audits approved subsequent to publication of the plan. During the entrance conference, **management officials should be encouraged to discuss their high-risk areas and bring any problem areas, concerns, and ideas to the attention of audit team members then or at any time during the audit process.**

Auditors should recognize that an overemphasis on **control** could make some managers feel that the auditor is in some way attempting to reduce their choices or scope of decisions. Managers

recognize that control is one of the management functions, but they do not always think explicitly about control. Therefore the language of control can be foreign to them. On the other hand, the word risk does not conjure up the same vision of constraints as that of the word control. Managers do think about risk and talk about risk. Risk is part of their language. Risks at the audit level can be aggregated at higher levels and tied to business risks that are part of the organization's strategic plan.

During the entrance conference, management officials should be advised of the following:

- 1. Purpose.** The goal of the survey is to (a) identify high-risk areas and related material weaknesses and significant potential problems and (b) properly refine the audit objectives, scope, and completion date.
- 2. Elevating issues.** Significant issues disclosed during the survey will be brought to the activity's attention and could be elevated immediately to higher echelons of command for timely action even though the issues are not fully developed as audit findings.
- 3. Provision of survey results.** The senior management official will be advised of the overall survey results and the decision to proceed or not to proceed into the verification phase of the audit. If the audit is curtailed as a result of survey audit work, a written report on the results of the survey will be provided (paragraphs [305.4](#) and [408](#) apply).
- 4. Need for auditor access.** If appropriate, the official should be informed of the need for auditor access to computer stored/processed data for evaluation using microcomputers, and/or the need for auditor training on the use of the activity's computer inquiry and report generator capability.
- 5. Investigator as team member.** When an investigator is assigned as a member of the survey team, advise management officials that the investigator is a member of the audit team ***under the direction of the supervisory auditor.*** Should the status of the investigator change, officials will be advised.
- 6. Electronic report distribution.** Draft and final reports will be distributed by e-mail unless they contain classified or other sensitive information. With that in mind, senior officials should be asked to assist the auditors in identifying the correct report distribution. They should also be asked to help us in obtaining an up-to-date list of e-mail addresses for report addressees as well as those that will receive information copies.

The start of "field work" should **normally** be the controlling event for opening an audit **(including a contract audit)** in DAMIS. "Field work" can start when you have **reasonable** access to personnel and records (including databases) such that you can begin to pursue the objective(s) laid out in the Project Planning Worksheet. In some cases, this can be done electronically, telephonically, or through video teleconferencing without leaving the home base; i.e., WNY Building 219, Virginia Beach office, or San Diego office. In other words, depending on the circumstances of a particular audit, "field work" can begin without physically going into the "field." Once effort to pursue/refine the audit objective(s) is underway, "field work" is underway and the audit should be "open." The audit number (**not research**) can and should be

charged prior to this date. The survey entrance conference is **normally** consistent with starting the “field work.” In some cases, there are unavoidable delays between the entrance conference and the start of “field work.” For example, you have an entrance conference but management has legitimate reasons why you can't start the “field work” for several weeks. In this case, wait until you start the “field work” to “open” the audit in DAMIS which in turn starts the calendar day clock.

405 – REFINEMENT PROCESS

1. Procedures. Generally, the objective(s), scope, and planned completion date for individual audit topics are not refined through audit research; that being the case, the audit survey must be used for that purpose. The Project Manager and other audit staff can use the following procedures (wholly or partially) to refine the objective(s), scope, and/or the completion date of a planned or requested audit.

- a. Compile all readily available information related to the audit topic (e.g., information on our possibly related prior, ongoing, and/or planned audits) by directly accessing such information on our [WEB site](#). Also, review possibly related prior [Audit Programs](#).
- b. Gain a clear understanding of planned/requested work and the desired/required completion date by discussing the topic with the client and/or members of the client's staff. The optional [Pre-Audit Customer Survey](#) or elements of the survey can be used as part of this process.
- c. Do Internet “key word” searches on the subject matter and search the [GAO](#) and [DODIG](#) WEB sites to identify related audits.
- d. Discuss the planned/requested audit work with our most knowledgeable internal resources. Use the “key word” feature of our [Audit Skills/Functional Area Knowledge Database](#) to aid in identifying these internal resources. These internal resources may, in turn, make referrals to external resources that should also be consulted and/or to prior audits, and related working paper files, which should be examined.
- e. Evaluate relevant documents/reports/studies that were identified by previous steps.
- f. Based on knowledge gained from steps above and, if appropriate, after further discussion with the client and/or the client's staff, provide the Audit Director a recommended course of action with supporting rationale. Possible recommendations include:
 - Pursue the topic unmodified in terms of objective(s), scope, and completion date.
 - Don't pursue the topic.
 - Refine the topic in terms of objective(s), scope, and/or completion date.

2. Exclusions. As a **general rule**, a topic (or portion of a topic) should not be pursued as a separate audit if:

- a. The area of concern is based on a request and it's already included in a scheduled audit or can more appropriately be included in a scheduled audit.

- b. The work is not within the definition of audit (for example, assistance needed to develop accounting systems, reconstruct records, or reconcile discrepancies).
- c. The work is the subject of an ongoing investigative action and audit would be inappropriate.

Among others, exceptions to the general rule stated above could include some CFO or NCIS work.

3. Summary. The goal of the audit topic refinement process is to be proactive in properly defining the objective(s), scope, and/or the completion date of planned/requested work. By properly defining objective(s), scope, and the completion date, we should be able to produce a professional product in a reasonable period of time consistent with the client's needs.

406 -- SURVEY PLAN/PROGRAM AND SURVEY DEBRIEF

1. Policy. As a general rule, written Survey Debriefs will be prepared and submitted to the responsible Assistant Auditor General for approval prior to the audit verification phase. Exceptions include Commercial Activity Reviews and some mandated audits. Other exceptions must be approved, *in writing*, by the responsible Assistant Auditor General prior to the verification phase and documented in the working papers. **In instances where the survey phase is skipped, an audit program is still required (Part III of this Chapter applies).** To facilitate continuation of audit work following the survey, the responsible Assistant Auditor General may provide oral direction to the Audit Director/Project Manager. To avoid misunderstandings, oral direction *will* be confirmed in writing as soon as possible.

2. Contents. Generally, a survey plan/program will be developed early in the audit to gather the following information that will in turn comprise the content of the Survey Debrief.

- a. Background information about the program, system, activity, or function(s) to be audited.
- b. Auditee comments, suggestions, and other pertinent results of the entrance conference.
- c. A statement concerning coordination with other Government auditors, investigators, and inspectors, when applicable.
- d. A statement indicating whether prompt and appropriate corrective actions³ have been taken by officials of the audited organization(s)/program(s) on the recommendations and potential monetary benefits in the most recent audit(s) by the Naval Audit Service, the

³ A specific followup objective is used **ONLY** when followup is the primary purpose of the audit.

General Accounting Office, Department of Defense Inspector General, or contract auditors.⁴

- e. A statement should address whether the auditee has taken appropriate action to correct significant/material problems (related to the scope and objectives of the audit) identified as a consequence of inspections or management/contractor reviews.
- f. When applicable, a summary statement on related contractor efforts.
- g. A summary of the results of the auditor's preliminary evaluation of the existing system of internal controls as related to the audit scope and objectives.
- h. Identification of automated systems/databases from which data should be extracted to perform the audit. This should include an assessment and comment on the capabilities and resources needed to validate the reliability of the systems/databases, including the accuracy of the output. This should also include a discussion concerning the availability of automated data retrieval software, maintained and used by the auditee(s), which can be used by the audit staff.
- i. A firm recommendation to either proceed into the verification phase or curtail audit work. If a recommendation is made to stop after survey, the steps performed during survey, and the results of those steps, should be detailed in the working papers.
- j. Audit objectives and scope and, if applicable, justification for proposed changes in objectives and scope.
- k. A description of known or potential material findings (**both positive and negative**) and potential monetary benefits (paragraph [608](#) contains further details on potential benefits). Test results supporting known problems will be included.
- l. A proposal as to where audit results should be addressed.
- m. Technical support requirements, such as data processing software, computer specialists, statisticians, or contract specialists (paragraph [309.3](#) applies).
- n. Identification of the universe or database for statistical sampling and detailed guidance on the use of statistical sampling. Guidance will include the confidence levels, sampling precision, estimated population size, the method of sample selection, and format for reporting statistical sample results (paragraph [606.1](#) applies).
- o. Audit assistance required or anticipated from other Directorates, identified by location, or from other Government audit agencies (such as the Department of Defense Inspector General, Army Audit, Air Force Audit, and Defense Contract Audit Agency).

⁴ Guidance from the Director, Policy and Oversight Division will be requested for problems that surface with prior recommendations on potential monetary benefits not related to the current audit objectives.

- p. Who will be responsible for audit supervision -- the Project Manager, the Audit Director or a combination of effort between the audit offices? When assist offices provide supervision, the survey debrief should indicate that all audit leads and draft findings will be coordinated with the Project Manager before development and/or discussion with management.
- q. Estimated audit hours and calendar days by activity, location, function, and/or problem area, as appropriate.
- r. Milestones showing a time-phased plan to complete the assignment and publish the report. The audit verification phase (the time from end of survey until the draft report is issued to management) should normally be scoped so it is completed in 150 calendar days or less. AAGs have discretion in this area based on scope, complexity, and other factors.
- s. Travel fund requirements for the total assignment. If the auditor proposes a significant change in the travel budget from what was originally planned, the survey debrief must clearly display the planned and proposed amounts and the reasons for the proposed change.
- t. An impact statement that indicates how the audit will affect the execution of the Annual Audit Plan, if the proposal **significantly** increases or decreases the resource requirements indicated in the approved Annual Audit Plan. The impact statement is to address other planned audits to include significant delays, suspensions or cancellations.
- u. An audit program ([Part III of this Chapter](#) applies). An index of prior [Audit Programs](#) has been created to assist in this effort.

407 -- BRIEFING SURVEY RESULTS

1. Internal briefings. Project Managers should be prepared to provide briefings to the Auditor General/Deputy Auditor General and/or their Assistant Auditor General on survey results (paragraph [307.6d](#) applies). Regardless of whether the briefings are to be formal or informal, the Project Manager should be able to discuss all aspects of the survey up to the date of the briefing. Such briefings will include essential background information, a summary of the areas reviewed, conditions found, and how the objectives were satisfied, deleted, or revised. The Project Manager should also have full knowledge of and be prepared to discuss those surveyed areas in which no deficiencies were found. Significant deficiencies or sensitive areas disclosed during survey should be brought to the immediate attention of the Audit Director. Direction from the Audit Director should be documented in the working papers. The [Working Paper Review Sheet](#) is the preferred format to document supervision (paragraph [510](#) applies).

2. External briefings. During the survey phase, most audit leads represent potential conditions that have not been substantiated. For this reason, auditors normally do not formally brief management officials during the course of the survey. However, management officials should be given a general idea of the survey progress. After approval by the AAG, overall survey results should be discussed with senior client management at the end of the survey phase or the beginning of the verification phase. The Audit Director/Project Manager will coordinate and

participate in end-survey meetings with Flag and Senior Executive Service level client management to discuss audit objectives, scope and methodology. When a decision is made by the responsible Assistant Auditor General to brief senior Department of the Navy (Secretariat, Flag, and/or Senior Executive Service) staff on interim or final survey results, management at the audited level should first be advised of such results.

408 -- CURTAILING AUDIT AFTER SURVEY

The absence of material problems and the validation of an acceptable system of internal controls or an inability to address the audit objective(s) will support a determination that additional expenditure of audit resources beyond the survey phase is not appropriate. In the former instance, **a positive conclusion or finding on the area reviewed should be reported.** However, it is important to communicate a positive conclusion in such a way that the user of the audit report will not be given the impression that the activity, program, or function audited has absolutely no problems. **Care should be taken in stating the audit scope, methodology, and objectives that were the basis for the positive conclusion.** A curtailment letter is appropriate when insufficient audit work was performed to complete any announced objectives (paragraph [305.4](#) applies). If audit effort is curtailed at the end of the survey, an exit conference will be held with management. Also, if assist work from other Directorates was previously planned during the verification phase, all affected audit management personnel will immediately be notified that the assist work will no longer be required.

PART II -- REQUIRED REVIEWS

409 -- SPECIAL AREAS TO ADDRESS

1. Coordination with other review groups.

- a. The SR Directorate will provide copies of related GAO and DODIG announcement letters to the Assistant Auditor Generals. The senior client management official will also be queried as to any knowledge of impending audits or inspections by any organization external to the command or activity.
- b. The Naval Criminal Investigative Service will be contacted by the audit team to determine whether it has any current interest in the subject of the audit -- within the audit objectives and scope. When the combination of survey and verification time will exceed 6 calendar months, the Naval Criminal Investigative Service will be contacted a second time to ascertain whether there is any new interest in the ongoing audit.
- c. When reliance is to be placed on work of other groups that have performed reviews, audits, or inspections (such as local audit, external audit, and/or Department of the Navy/external inspections) in areas within the objectives and scope of the ongoing survey, the auditor must assess the groups' capabilities, independence, and performance. This can be done by:

- (1) Determining their objectivity and professional qualifications or professional reputation.
- (2) Reviewing documentary evidence in their working papers.
- (3) Performing appropriate tests of their work before accepting their reports as a basis to modify the planned scope or revise the planned audit objectives. This can be accomplished by examining some of the transactions, balances, or work that the other group examined.

If the work of other groups is considered adequate, the planned audit coverage may be reduced. If the work is considered inadequate, or the scope and depth of coverage cannot be ascertained, the planned audit objectives and scope should not be reduced. The nature and extent of testing of the data depends on the significance of the data in relationship to planned audit objectives, scope, and/or anticipated findings.

2. Followup. The SR Directorate will be asked to provide the current status of prior recommendations and potential monetary benefits that are identified by the Project Manager to the objectives and scope of the current audit. The audit team will ascertain whether prompt and appropriate corrective actions have been taken on those recommendations and any recommendations from external reports -- such as from Defense Inspector General audits, Department of the Navy Inspector General reports, and/or General Accounting Office reports -- that are more current than the recommendations in previous Naval Audit Service reports (paragraph [703](#) applies). The survey package will include information on the current status of prior audit recommendations and potential monetary benefits.

3. Areas susceptible to fraud, waste, or abuse. The audit survey and related audit program (for the verification phase of the audit) should be designed to provide *reasonable* assurance of detecting fraud, waste, or abuse that could **significantly** affect the audited program or activity **within the objectives and scope of the audit**. It is not feasible to provide reasonable assurance of detecting *all* illegal acts or abuse. If internal controls are weak, audit steps should be extended to **detect situations or transactions that could be indicative of fraud, waste, or abuse that could materially or significantly impact on the audit as well as the audited entity's financial statements, operations, or program**. When the possibility of fraud is indicated, the Project Manager must discuss it with the Audit Director and Assistant Auditor General. Where appropriate, the Audit Director will coordinate issues with legal counsel. If it is determined that sufficient evidence exists, auditors will coordinate their examinations with applicable investigative agencies. **Paragraph [415.1](#) provides additional guidance for developing the necessary guide program steps. Paragraph [615](#) provides additional factors that should be considered and includes fraud characteristics and indicators in [subparagraph 6](#).**

4. Special concerns for surveys of major procurement and contract administration functions.

- a. During the survey phase of major procurement and contract administration audits, auditors should determine the existence and consider the impact of audits issued by the Defense Contract Audit Agency. Such reports should be available at the command under

review. If not, copies should be requested in accordance with guidelines in paragraph [309.2.b](#). Auditors should also determine during the survey phase whether any related contracts are administered by organizations other than the Department of the Navy, such as: Department of the Army; Department of the Air Force; or Defense Contract Management Command. Contacts with these organizations, as approved by the responsible Assistant Auditor General, will also help the auditor determine areas to be covered during the verification phase.

- b. Auditors should ask the contracting officer if any fraud letters have been received from the Defense Contract Audit Agency and determine, when applicable, whether action has or is being taken on the allegation(s). Previously identified areas of potential fraud should be evaluated during the verification phase.
- c. Assistance from the Defense Contract Audit Agency or review of contractor records must be approved in advance by the responsible Assistant Auditor General (paragraph [309.2.b](#) applies).

410 -- EVALUATING INTERNAL CONTROLS

Internal controls should support the efficient and effective achievement of organizational objectives. Too little control puts the organization at risk. Too much control is expensive and becomes a barrier to efficient work processes. The challenge for auditors, who function as control experts, is to recommend cost effective controls that preserve and create value by aiding in the management of risks which, in turn, promotes the achievement of organizational objectives.

GAGAS require an auditor to **obtain an understanding of internal controls** that are **relevant** to each audit and assess general and application controls for **relevant** computer-based systems in circumstances where computer generated data are **significant in relationship to the audit scope and objectives**. **When internal controls are significant to audit objectives, auditors must obtain sufficient evidence to support their judgements about those controls.** To meet these requirements, the auditor must test internal controls by determining if **relevant** transactions have been handled in accordance with **appropriate** criteria.

1. General.

- a. Internal controls are the policies and procedures adopted by management to provide reasonable assurance that:
 - Established goals and objectives are achieved.
 - Resources are used consistent with laws, regulations, and policies.
 - Resources are safeguarded against waste, loss, and misuse.
 - Reliable data are obtained, maintained, and fairly disclosed in reports.

- b. With few exceptions, instances of waste, abuse, mismanagement, fraud, or unfavorable public opinion have resulted from management's failure to establish and maintain effective and efficient internal controls.
- c. **Consistent with the audit objectives and scope (i.e., the organization, program, activity, or function under review) and risk assessment results (paragraph [402.2](#) applies), auditors must perform and document a preliminary review of the relevant aspects of the system of internal controls.** This review is generally *not* stated as a specific objective except when a major objective of the audit is to evaluate internal controls, such as in financial audits. The review may include selective testing of relevant controls to determine whether they are effective and being followed. Testing could include tracing sample transactions. Optional [“Factors to Consider when Evaluating Internal Controls”](#) are provided in the linked document. GAO's [“Standards for Internal Control in the Federal Government”](#) can also aid in this effort. **The Audit Director must advise the responsible Assistant Auditor General when and why a preliminary review of internal controls is not contemplated as part of the audit survey.**
- d. If internal controls are not adequate, audit steps and procedures may need to be extended during the verification phase to: (1) identify material weaknesses; (2) identify the affect on the activity's financial statement(s), reports, operations, or programs; and (3) recommend corrective action (paragraph [604](#) applies).
- e. **The audit report must identify any significant/material weaknesses in internal controls that relate to the audit objectives and scope.**

2. Computer-based systems. As part of the internal control evaluation, auditors are required to assess general and application controls for computer-based systems in circumstances where computer generated data are significant to the audit objective(s) and scope (paragraph [412](#) applies).

3. Financial audits. For financial audits, sufficient work will be done to provide management an opinion on the adequacy and effectiveness of internal controls. Auditors should form a judgement as to whether the control environment enhances internal control policies and procedures or causes them to be less effective. Optional [“Factors to Consider when Evaluating Internal Controls”](#) are provided in the linked document. Detailed findings will be developed regarding any deficiencies that could have a significant impact on financial operations. If the control environment causes the internal policies and procedures to be less effective, then the auditor should report this. The Federal Managers' Financial Integrity Act requires that management be made aware of the adequacy and effectiveness of internal controls to ensure the safety of assets, provide reliable data, and protect sensitive or classified information. Paragraph [609.3.i](#) provides additional guidance and references. A report on internal controls is required as part of any audit performed under the CFO Act. [Chapter 9](#) provides guidance on reporting the results of financial audits performed under the CFO Act.

4. Economy and efficiency audits. For these audits, a category of performance audits, auditors *must* review the policies, procedures, practices, and controls (accounting and administrative)

applicable to the objectives and scope of the audit to determine whether the activity is using its resources economically and efficiently.

5. Program audits. For program audits, also a category of performance audits, auditors *must* review the policies, procedures, practices, and controls (accounting and administrative) applicable to the objectives and scope of the audit that have a specific bearing on attaining the activity's goals and objectives, including those specified by law or regulations.

411 -- REVIEW FOR COMPLIANCE

1. General. All audits require some determination of compliance with laws and regulations. Laws and regulations applicable to a specific Government organization, program, activity, or function are often so numerous that the auditors cannot be expected to review every one that might in some way have an impact. Consequently, such a review requires considerable judgement. Some sources of information on legal and regulatory requirements are:

- Basic legislation.
- Reports of congressional hearings.
- Legislative committee reports.
- Annotated references from reference services covering related court decisions and legal opinions.
- Historical data related to the legislative history of authorizing legislation.
- Memoranda from Federal administrative agencies.
- Federal guidelines and other administrative regulations affecting program operations.
- [Federal Legal Information through Electronics](#) (FLITE).
- [Department of Defense](#) Subject Index and [Department of the Navy Regulations](#).

2. Financial audits. For financial audits, compliance shall be listed as one of the specific objectives of the audit in the "Objectives" section of Section A. The results must be included in a separate report, under the caption *Report on Compliance with Laws and Regulations*, in Section B and summarized in the Executive Summary ([Chapter 9](#) applies). This report must include a scope paragraph and an opinion paragraph. The scope paragraph will include the scope of the auditor's examination, including an explicit statement of the information the auditors examined. The opinion paragraph will contain a statement of positive assurance on compliance with laws and regulations for items tested and negative assurance on items not tested.

3. Performance audits. For performance audits, compliance is not usually stated as an objective for the audit although noncompliance with laws and regulations must be identified in the audit report. It should be recognized that understanding the program being audited requires

an understanding of relevant laws. Noncompliance should be summarized in the Executive Summary for each applicable objective, and in detail in Section B ([Chapter 8](#) applies).

412 -- COMPUTER OUTPUT RELIABILITY

1. General. Products of any information system, whether automated or not, can be inaccurate. Auditors should not accept computer products at face value for several reasons. First, alterations to data in computer files are not readily apparent when reviewing a computer product. Second, the computer product's reliability is affected by data processing controls that may not be consistently used. **The reliability of computer-based products must, therefore, be evaluated to determine risks in using such products that are significant to the audit objective(s) and scope.**

2. Procedures.

- a. When evaluation of a computer-based system is the primary objective of an audit, GAGAS require auditors to evaluate both general and application controls in the computer-based system. Paragraph [611](#) provides guidance for conducting these evaluations.
- b. GAGAS also require that a scaled-down evaluation of general and application controls be conducted for other audits when computer-processed data is an integral part of the audit and *the data's reliability is crucial to accomplishing audit objectives*. The auditor should have reasonable assurance that the scope and nature of the tests and procedures selected are sufficient to provide reasonable assurance that the computer-processed data is relevant, accurate, and complete for its intended use. When a scaled-down evaluation is appropriate, auditors should tailor their efforts to the particular situation considering guidance provided in the [General Accounting Office's Federal Information System Controls Audit Manual \(FISCAM\)](#). The auditor's efforts *should be limited to those necessary to meet the audit objectives and should not include an evaluation of total automated systems at multiple Department of the Navy locations, unless that is the specific goal of the audit*. Examples of evaluation steps include confirming computer-processed data with independent sources; comparing the data with source documents; and reviewing agency test procedures and results. Selective statistical testing should be used when computer-processed data is voluminous.
- c. As a general rule, auditors need not validate commercially acquired software since such validation should have been performed during the acquisition process.
- d. When reliability assessment work is completed, the auditor should prepare a memorandum for the working papers summarizing work done and conclusions. (The [General Accounting Office's FISCAM](#) includes an outline of a summary memorandum.) The degree of testing needed to determine data reliability generally increases to the extent the general or application controls are determined to be unreliable or are not reviewed. If reasonable validation of accuracy and reliability of data was not accomplished, full disclosure should be made in the scope section of the audit along with a clear explanation of the reasons for the limitations.

- e. In arriving at some audit conclusions or in developing background information for the audit report, the auditor may rely on computer-processed data that are not significant to the audit results. In such a case, the auditor is not required to test the data for reliability. Where applicable in such a case, the scope section of the report should indicate that the data were not tested for reliability.

PART III--AUDIT PROGRAM

413 -- DEFINITION

An audit program is a guide to performing an audit and preparing the resulting audit report. It describes the procedures and techniques that will be employed to execute an audit **in the most efficient and effective manner**. The audit program should provide, in reasonable detail, the **minimum** audit steps believed necessary to accomplish the audit objectives. On the other hand, the audit program should not be used strictly as a checklist or in a way that restricts the auditor's initiative, originality, or professional judgement. As an audit progresses, the audit program must be modified, if appropriate, based on the results of the audit work.

414 -- PROCESS OVERVIEW

The process of developing an audit program consists of:

- Assigning responsibility for developing the audit program to someone knowledgeable of the subject to be audited, if possible.
- Obtaining background information on the subject. An index of prior [Audit Programs](#) has been created to assist in this effort.
- Performing a risk-based audit survey (paragraph [402.2](#) applies).
- Establishing or refining audit objectives as part of the survey process (paragraph [405](#) applies).
- Writing audit steps to accomplish the audit objectives and cover the other items discussed in paragraph [406.2](#).

The audit program is not a static document; it must be modified as the audit progresses based on the results of the audit. Some areas thought to be potential problem areas during the survey phase may prove to be operating effectively thus eliminating the need to execute some audit steps. On the other hand, other problem areas not found during the survey phase may surface. The audit program has to be modified to accommodate these situations.

415 – PROGRAM DEVELOPMENT

1. Requirements. The Naval Audit Service does not maintain standard audit programs. A unique, written audit program will be prepared for each audit -- based on survey results -- before the start of the audit verification phase. A written program or guide, though not as detailed as an audit program, will be developed for each survey project (paragraph [406.2](#) applies). Each audit program will be designed to:

- Answer established audit objectives.
- Assess the adequacy and effectiveness of applicable internal controls.
- Determine compliance with applicable laws and regulations.
- **Provide reasonable assurance of detecting fraud and other illegal acts that could significantly affect the audit objectives or have a direct and material effect on financial statements or the results of financial-related audits.**
- Evaluate actions taken in response to previous audits and reviews, where applicable.

In deciding what audit steps are necessary to detect fraud or other illegal acts, the auditor should **assess the risk that significant illegal acts could occur**. That risk may be affected by such factors as the complexity of the laws and regulations or their newness and the effectiveness of the audited activity's controls in preventing or detecting illegal acts. Auditors might ask: (1) who is in the best position to commit a fraud or other illegal act; (2) why would they do it or what do they have to gain from it; and (3) what scheme(s) would they use? Auditors should develop audit steps that would satisfy their interest in the above questions if there could be a **significant impact on the audit objectives**. If audit tests indicate fraud or some other significant illegal act might be occurring, auditors should then consider developing more stringent steps to determine the extent of these acts. Auditors should exercise due professional care in pursuing indications of possible illegal acts so as not to interfere with potential investigations, legal proceedings, or both. **Fraud and other illegal acts, including characteristics and indicators of fraud, are discussed at greater length in paragraph [615](#).**

Auditors should also be alert to situations or transactions that could be indicative of **abuse**, which is defined as "the conduct of a government program that falls far short of societal expectations". When information comes to the auditor's attention indicating that abuse may have occurred, auditors should consider whether the possible abuse could **significantly affect the audit results**. If it could, the auditors should extend the audit steps, as necessary, to determine if the abuse occurred and, if so, to determine its effect on the audit results. However, because the determination of abuse is so subjective, auditors are not expected to provide reasonable assurance of detecting it.

2. Approvals. All programs must be approved by the responsible Audit Director and Assistant Auditor General before the start of the audit verification phase.

3. Changes. The responsible Assistant Auditor General must be advised of any **significant** changes to the audit program. In the case of multilocation audits, the responsible Audit Director must approve, in advance, any departures from the audit program. Audit working papers must document the basis for, and approval of, any deviations from the approved audit program.

416 -- AUDIT PROGRAM BENEFITS

A well-constructed audit program has many benefits. The audit program provides a systematic series of audit procedures that can be communicated to the audit team members. Other benefits include providing:

- A basis for estimating time requirements, arranging and distributing audit work, and recording and measuring audit progress.
- A basis for creating a summary record of work accomplished.
- A starting point for independent appraisers to evaluate audit performance.
- A training tool for an auditor reviewing a new functional area or program and for reviewing compliance with laws and regulations applicable to that area or program.

417 -- CONTENT

An audit program should include:

- Background information on the subject audited.
- Purpose and objectives of the audit.
- Scope of the audit.
- Definition of unique terms used by the activity or function audited.
- Special instructions to ensure that auditors understand the objectives of the audit and what needs to be done. For example, use of consultants or technical experts might be discussed. The importance of technical expertise and guidelines for obtaining technical assistance are provided in paragraph [309.3](#).
- Audit procedures (audit steps and methodologies). Examples of procedures or methods available to an auditor include: interviewing and the use of surveys, basic data gathering and analysis, non statistical sampling and transaction testing, organizational and systems analysis, cost-benefit-analysis, and various forms of statistical sampling and analysis.
- Cross-references to the supporting audit working papers.

Due care is to be exercised in the design of an audit program to provide reasonable assurance that the audit will detect material errors, irregularities, and illegal acts that could significantly affect the audit objectives or that could have a direct and material effect on financial statement amounts or the results of financial-related audits.⁵ It is not economically feasible or reasonable to design an audit program to detect all illegal acts.⁶

418 -- RESPONSIBILITIES

1. Development. The Project Manager will oversee the development and preparation of the audit program, which will be included in the Survey Debrief submitted to the responsible Audit Director and Assistant Auditor General for approval before the audit verification phase of an audit begins. An audit program should be flexible and permit a Project Manager to deviate from prescribed audit steps or to extend the audit beyond the audit program's requirements when sound judgement indicates a need to do so. Changes to audit programs being used by more than one audit team must be coordinated, in advance, with the Audit Director responsible for the overall audit.

2. Execution. The audit program does not eliminate the need for supervision during the audit. **Supervisory reviews must be made as an audit progresses to determine whether: (1) the audit program is being followed and the audit objectives accomplished, (2) revisions are needed to the audit program to answer the audit objectives and eliminate any unnecessary effort, (3) work should be continued or curtailed, (4) working papers are adequate and the minimum necessary, and (5) conformity with auditing standards is being maintained.**

419 -- OBTAINING BACKGROUND DATA

Background information on the subject to be audited can be obtained by: research; reviewing findings and recommendations in prior audit reports or Navy inspection reports; and reviewing prior [audit programs](#), if applicable. As a general rule, the procedures discussed below should be used as part of the survey/audit program development process (paragraph [405.1](#) also applies).

1. Applicable criteria. Compile and research all *pertinent* Navy or Marine Corps directives on the subject, including manuals, instructions, professional articles, and other similar information. If necessary, obtain pertinent Department of Defense directives for further clarification on requirements. When citing directives and references in the audit program ensure that they are current by using the Department of Defense and Department of the Navy consolidated subject indexes. Also, a directive or reference should be cited after each audit step where possible. Cite the lowest level directive applicable. Paragraph [828](#) provides related guidance.

⁵ Error refers to unintentional misstatements, oversights, or misinterpretations, including mathematical and clerical mistakes and oversights. Irregularities refer to an intentional misstatement or omission and may involve acts such as manipulation, falsification or alteration of accounting records or reports; or, omission of events, transactions, or other significant information. Illegal acts refer to deliberate violations of laws. Whether an act is, in fact, illegal is a determination that is normally beyond the auditor's professional competence.

⁶ Comments on Statements on Auditing Standards No. 53, Auditing Standards Board, American Institute of Certified Public Accountants, April 1988.

2. Other audit, inspection, and investigative reports. Review findings and recommendations in General Accounting Office; Inspector General, Department of Defense; Army Audit Agency; Air Force Audit Agency; and Naval Audit Service audit reports that relate to the audited area. Navy inspection and investigative reports, if available, should also be reviewed.

3. Prior audit program. Review the [audit program](#) from the preceding or similar audit(s), if applicable, before preparing the program for the current audit. An index of prior Audit Programs has been created for this purpose. The current audit program should reflect modifications made as a result of the experience gained in prior examinations and show changes in the internal control or accounting methods of the activity.

420 -- OBJECTIVES AND SCOPE

The audit program is keyed to the audit objectives, which should state exactly what is to be accomplished during the audit. When an audit is planned, objectives are established for that audit. Based on the survey results, these audit objectives are refined before incorporation into the audit program. Some may be deleted or refined to avoid duplication of audit effort, due to low materiality or risk, or due to a lack of identified potential problem areas (if survey work was insufficient to justify positive reporting). For some audits, objectives should be added to address material issues, high risks, or problem areas identified during the survey.

1. Basic objectives. The objectives depend on the type of audit. In writing objectives for the audit program, consider the following basic objectives depending on the type of audit being accomplished.

- a. Financial statement and financial-related audits.** Financial statement and financial related audits can include determining whether:
 - (1) The financial statements of an audited entity present fairly the financial position, results of operations, and cash flows or changes in financial position in accordance with generally accepted accounting principles.
 - (2) The entity has complied with laws and regulations for those transactions and events that may have a material effect on financial statements.
 - (3) Internal controls are adequate and effective.
 - (4) Financial reports and related items, such as accounts, or funds, are fairly presented.
 - (5) Financial information is presented in accordance with established or stated criteria.
 - (6) Specific financial compliance requirements have been adhered to.
- b. Performance audits.** Economy and efficiency and program audits can include determining:

- (1) Whether resources (such as funds, personnel, property, and space) are being acquired, protected, and managed economically and efficiently.
- (2) The causes of uneconomical practices or inefficiencies.
- (3) Whether, and the extent to which, desired results or benefits established by the Congress or other authorizing bodies are being achieved.
- (4) The effectiveness of the organization, program, activity, or function.
- (5) The need for and appropriateness of the program.
- (6) Whether established goals or performance objectives are being met.
- (7) The adequacy of the measurement and evaluation criteria that management uses for the program.
- (8) Whether viable alternatives to the program exist which might yield desired results at lower cost.
- (9) The cost-benefit relationships pertinent to the program.
- (10) The adequacy and effectiveness of internal controls.
- (11) Whether applicable laws and regulations have been complied with.

2. Specific objectives and scope. For the audit program to be effective, it needs to be segmented by area. **In each section of the audit program, specific goals, which are tied back to the audit objectives, should be spelled out** (paragraph [819](#) provides related information). Scope should answer such questions as: Is the whole program or function to be audited? What period of time is to be covered? Is the audit of an activity at a single location or does it cover many locations? Paragraph [820](#) provides related information.

421 -- WRITING AUDIT STEPS

1. Level of detail. Audit steps should clearly detail the work to be done and the extent of tests to be made. When appropriate, specify the procedures and advanced auditing techniques to be used in performing audit steps. Advanced auditing techniques include microcomputer applications, computer matching, statistical sampling applications, automated retrieval techniques, and micro-to-mainframe link (downloading). **Write audit steps so that an auditor can achieve the specified goals with a minimum of supervision.** Precise instructions are most likely to produce desired results.

2. Tailoring to the assignment. Audit programs should be tailored to the audit assignment. **Each programmed work step should relate to the specified goals included in each section of the audit program.** To ensure that the reasons for performing the audit steps are clear for each specified goal, the listing of audit steps should be preceded by a brief background paragraph related to each goal. Where applicable, **this requirement can be met by including a separate**

section in the audit program for each proposed audit finding identified during survey. The audit steps in each finding section should be organized and labeled with a heading in reference to the part of the finding they pertain; i.e., steps for the condition, steps for the criteria, steps for the cause, and steps for the effect. For the audit program to be cost effective and flexible, the program should indicate the relative priority of the program sections and the work steps within each section. **By executing the most important parts of the program first, audit managers will be in a better position to eliminate unnecessary effort and complete the audit within the allotted/minimum time.** To minimize misinterpretations of audit steps, avoid legalistic language, vague terms, and long involved sentences. Also, uniform meanings should be provided for common terms used in audit programs. Examples of such terms are:

- **Analyze.** To break into significant component parts to determine the nature of something.
- **Check.** To compare or recalculate to establish accuracy or reasonableness.
- **Confirm.** To prove to be accurate, usually by written inquiry or by inspection.
- **Evaluate.** To reach a conclusion as to worth, effectiveness, or usefulness.
- **Examine.** To look at or into closely and carefully to arrive at accurate, proper, and appropriate opinions.
- **Inspect.** To examine physically.
- **Investigate.** To ascertain facts about suspected or alleged conditions.
- **Review.** To study critically.
- **Scan.** To look over rapidly in order to test general conformity to pattern, noting apparent irregularities, unusual items, or other circumstances appearing to require further study.
- **Substantiate.** To prove conclusively.
- **Test.** To examine representative items or samples to arrive at a conclusion regarding the group from which the sample is selected.
- **Verify.** To establish accuracy.

422 -- PROGRAM FORMAT

The finished audit program will have a cover sheet, a table of contents, an "Introduction" section, a "General" section, and a section for each area to be reviewed. Provide a column on the audit program for the name or initials of the auditor, the date steps were performed, and the index reference to the applicable summary working paper opposite each step or group of steps. This permits the program to be used as a control device as well as a planning tool. The index

reference is extremely important for ready access to the evidence of work done and to facilitate navigation through the working papers.

1. Cover sheet. A [cover sheet template](#) has been developed to facilitate the indexing of audit programs. The cover sheet shows the title of the audit and provides the names, phone numbers and e-mail addresses for the audit managers. It also provides space to show the name of the audited activity/program, the names of the other participating auditors, the date the audit commenced, and the date the audit was published.

2. Table of Contents. The Table of Contents provides a description of each of the sections in the audit program. Each section is lettered alphabetically. The first section is the "Introduction" section and the second section is the "General" section.

3. Introduction section. This section normally includes the purpose of the audit program, a brief background on the subject to be audited, audit objectives, scope and methodology of the audit, guidance on reviewing internal controls, guidance on preparing working papers, general instructions, and references applicable to the subject to be audited. The following paragraphs provide general guidance for preparing working papers and writing general instructions.

- a. Instructions for preparing working papers.** Brief instructions on the general format of working papers should be included in the audit program. This facilitates consistency in preparing working papers and lessens the supervisory burden when reviewing working papers to ensure that the audit work was performed in accordance with generally accepted government auditing standards.
- b. General instructions.** General instructions usually state that the audit steps in the audit program are not intended to be restrictive or serve as a substitute for initiative, imagination, or judgment. They should also include a statement that all audit steps should be cross-referenced to any working papers developed in executing the audit steps and if audit steps are not accomplished, the reasons must be documented in the working papers.

4. General section. This section normally provides guidance on planning the audit. It would include audit steps to obtain background information for use in planning and conducting the audit.

5. Other sections. The remaining sections of the audit program are segmented by area. Each section would include a brief background on the specific area, examples of known or suspected problems (based on survey results), audit objectives, and audit steps to achieve those objectives.

CHAPTER 5

WORKING PAPERS

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PART I -- POLICY AND STANDARDS

501 -- GENERAL POLICY

A record of the auditor's work is to be retained in the form of working papers.

1. The term *working papers* means all records, documents, and other material (including electronic media or films) prepared or collected by the auditor during the research and audit process. As a minimum, working papers should document the following:

- Planning.
- Examination and verification of the adequacy of internal controls and compliance with applicable laws and regulations.
- Auditing procedures performed, relevant information obtained, and conclusions reached.
- Supervisory review of the working papers and disposition of review comments.
- All relevant audit results, including the modification or deletion of all proposed findings and recommendations. Reasons for deletion of proposed findings and recommendations must be included in the working papers.

2. Since working papers are the link between audit work and the audit report, they must include sufficient, competent, and relevant evidence that there is a reasonable basis for the auditor's conclusions.

3. Proforma (standardized) working papers should be provided, when practical, for multilocation audits, in cases where data needs to be consolidated, and should not be altered without the approval of the Audit Director.

4. Standard white or "Eye-Ease" color, 8- 1/ 2 x 11 inch narrative and columnar pads and 14 x 17 inch columnar pads, or a computer generated spreadsheet will be used unless deviation is approved in writing by the Policy and Oversight Division.

5. Working papers must be safeguarded at all times.

502 -- PURPOSE OF WORKING PAPERS

Working papers are the auditor's record of audit work performed. They provide support for audit coverage decisions, findings, conclusions, recommendations, and monetary benefits. Working papers provide a basis for the supervisor's evaluation of the audit staff's performance, and facilitate internal/external quality control/peer reviews.

503 -- STANDARDS OF EVIDENCE

Evidence is most convincing when it satisfactorily meets the standards of evidence:

1. Relevance. Information in working papers should be restricted to matters that are materially important and relevant to the objectives of the assignment. Information should be the most current available, and when it appears "old" its relevance should be reaffirmed. Having clear statements of purpose on the working papers helps to ensure that information accumulated is properly tied to the audit objectives. All working papers cited in the cross-referenced copy of the report and any pertinent legal memorandums must be retained. Documentation that explains why a certain audit approach was discarded, or why information related to the audit was omitted from the report, should be included in the working papers along with documentation of supervisory approval of such decisions. To avoid accumulating excessive details in the working papers, notes concerning issues beyond the stated objectives should be retained only until their relevance can be determined. The same level of due care must be exercised in preparing working papers as is used in performing an audit.

2. Sufficiency and accuracy. Working papers must be legible, sufficient, complete, and accurate. They are the basis, which support results, findings, conclusions, and recommendations, and show the scope of the work performed. Working papers should not: (1) consist solely of filled-in audit programs or checklists; and (2) need supplementary oral explanations. Auditors and supervisors must decide, by exercising professional judgement, whether information gathered is sufficient to satisfy stated audit objectives and support conclusions and findings. If conclusions cannot be reached on an area due to lack of access to records, the working papers should fully explain the effect on the audit and document all actions taken to obtain access. Paragraph [104](#) discusses auditor access to information. When appropriate, statistical methods should be used to establish sufficiency.

3. Competence. To be competent, working paper content must be valid and reliable. In evaluating the competence of evidence in working papers, auditors should carefully consider whether reasons exist to doubt the validity of the data. If doubt exists, additional evidence should be obtained or the matter fully disclosed in the report. The following precepts are helpful in determining the relative competency of evidence, but should not be considered solely in determining competence:

- a. Evidence obtained from an independent source is more reliable than evidence secured from the activity under audit.
- b. Evidence developed under a good system of internal controls is more reliable than evidence obtained where such control is weak, unsatisfactory, or nonexistent.
- c. Evidence obtained through physical examination, observation, computation, and inspection is more reliable than evidence obtained indirectly.
- d. Original documents are more reliable than copies.

- e. Testimonial evidence obtained under conditions where persons may speak freely is more credible than testimonial evidence obtained under compromising conditions (e. g., where persons may be intimidated).

504 -- CATEGORIES OF EVIDENCE

Evidence is the specific information obtained during audit work through such activities as observing events, questioning people, and examining and analyzing records and other data. Evidence obtained is considered in formulating judgements and in helping auditors arrive at appropriate conclusions. Logical arguments must be based on convincing evidence. Working papers must show the details of the evidence gathered by the auditors to support opinions and conclusions, and disclose why, how, and where the evidence was obtained. Evidence may be categorized as physical, documentary, analytical, or testimonial. An article entitled “[Top 10 Audit Deficiencies](#)” includes discussion on the importance of gathering sufficient and competent evidence.

1. Physical. Physical evidence is obtained by direct inspection or observation of activities or people, property, or events.

- a. The evidence may be in the form of memorandums summarizing the matters inspected or observed; listings showing the nature and extent of inspections; actual samples; and photographs, charts, maps, graphs, or other pictorial representations. Obtaining and using graphic evidence is a very effective way to explain or describe a situation. For example, a clear photograph of a storage facility illustrating improper or inefficient storage practices has a much greater impact than merely describing those practices with words.
- b. It is very important that auditors recognize the value of physical evidence and effectively use the technique of observation. For example, auditors can critically observe activities of people. Auditors should take every opportunity to observe the operations, property, or other resources of auditees because a condition actually seen and documented is one of the best forms of evidence.
- c. At least two staff members should make important physical inspections. Also, auditors should try to arrange for auditee or contractor representatives to accompany them on such inspections in order to further corroborate auditor observations.

2. Documentary. Documentary evidence consists of letters, contracts, accounting records, invoices, and similar material. Such documents can be:

- External -- those originating outside the audited organization (for example, incoming correspondence).
- Internal -- those originating within the audited organization (for example, accounting records, management reports, outgoing correspondence, receiving reports, negotiation files, and intra-agency correspondence).

- a. Auditors can rely more on an external document that was obtained directly from its source than on the same type of document obtained through the command since, in the latter case, the document may have been altered. Any apparent alterations should be investigated.
- b. Important factors affecting the reliability of internal documents include whether (1) they have circulated through outside parties, (2) the auditee's internal control procedures are adequate enough to assume their accuracy, and (3) the documents are to stand alone or serve to corroborate other forms of evidence.
- c. Internal procedures have an important effect on the reliability of documentary evidence originating in and circulated only within the command. For example, a timecard may be very reliable evidence of work performed when (1) the employee punched the timeclock, (2) his or her supervisor approved the card, (3) the payroll section (independent of production activities) checked the timecard against job tickets or production schedules, or (4) management officials made surprise floor checks.

3. Analytical. Analytical evidence is developed primarily by obtaining, examining, and making judgements about other forms of evidence. It consists of such efforts as computations, comparisons, reasoning, statistical sampling, and any other data analyses. Carefully developed analytical evidence can be very convincing, especially when auditors use properly developed and applied quantitative measures. Reasoning is employed in developing analytical evidence, not only in interpreting data and making judgments on each specific matter being addressed in an audit, but also in developing and justifying the logic framework for the entire assignment. The data quality must be determined for all types of evidence (physical, documentary, and testimonial) prior to it being used as analytical evidence. Some questions to consider in assessing analytical evidence include:

- Is the evidence based on a logical and carefully designed methodology?
- Does the evidence satisfactorily resolve the audit objectives/questions?
- Are all computations and comparisons mathematically accurate?
- If the analytical evidence is inconsistent with other evidence, is there a reasonable explanation or can the inconsistency be reconciled?

4. Testimonial. Testimonial evidence is obtained from others through oral or written statements received in response to inquiries or through interviews. *Testimonial evidence should normally be obtained from, or corroborated by, someone of authority and in a position to know the right answer.* Records of interviews may consist of memorandums based on notes taken during the interviews or recorded transcripts of entire conversations. Statements by officials or others (explanations, justifications, lines of reasoning, and intentions) are valuable sources of information not readily obtainable by other means. Standing alone, however, such statements may have limited value as evidence. *When statements are included in audit reports or concern matters crucial to the line of reasoning being developed, or when the potential for future legal action exists, they should be corroborated, if possible, by at least two independent*

sources, as well as obtaining physical or documentary evidence. Auditors should exercise the appropriate level of professional skepticism and corroborate management's statements/explanations with other evidence or challenge statements/explanations that are inconsistent or refuted by other evidence that has already been gathered. Auditors are cautioned against total reliance on testimonial evidence obtained from potentially biased sources when they lack objective means of verifying the accuracy of the evidence.

PART II -- PREPARATION

505 -- RELATION TO AUDIT PROGRAM

A written audit program will be prepared based on research or survey results and approved by the responsible Assistant Auditor General prior to starting the verification phase of the audit. Since the audit program serves as a planning and control tool for the audit and sets forth suggested steps and procedures for performing the audit, the working papers should dovetail with the audit program steps. [Part III of Chapter 4](#) provides guidance on the development of audit programs and the approval process for them. As an audit progresses, it may be necessary to add, delete, or modify audit program steps. **Ultimately, a summary working paper should be prepared for each audit program step (or group of steps) that is in the final audit program. Extraneous audit program steps should be deleted not documented and cross-referenced.**

506 -- INDIVIDUAL WORKING PAPERS

1. Planning. Before preparing an individual working paper, the auditor should develop a clear understanding of matters such as:

- a. The purpose of the working paper in relation to the anticipated final report and what value the working paper will add to the final report. *We need to avoid documenting for the sake of documenting.*
- b. What **minimal** information is needed to answer the audit objectives, support the audit findings, meet audit standards (e.g., documenting supervision, evaluating the quality of computer generated data), and support the utilization process. *The majority of working papers should be cross-referenced to the final report.*
- c. Where the needed information is located and how it will be obtained.
- d. What comparisons and other analyses are needed to prove a condition or conclusion.

2. Required information. The auditor's understanding of the audit objectives should result in efficient and effective working paper development.

- a. Each individual or group of working papers should include the following basic labeling information:

- (1) The audit title and job order number.
 - (2) A subject or heading that clearly identifies the schedule, exhibit, narrative, or other contents.
 - (3) The auditor's name.
 - (4) The date prepared.
 - (5) An index and page number for filing and referencing purposes.
 - (6) The "as of" date or period covered by the information used in the analysis.⁷
 - (7) Explanation of any tick marks or other symbols used.⁸
- b. In addition, each working paper analysis, or the first or last page of a multipage analysis must include the following fundamental information elements, which are crucial to the auditor's analysis:⁹

(1) Source of information.

- (a) This applies to schedules prepared by the auditee and furnished to the auditor, as well as to data compiled by the auditor. If listings, files, forms, or other documents are the source, the auditor should provide dates, titles, form numbers, and the specific locations of the data.
- (b) If source information is a machine printout, **both** the date of the printout and the "as-of" date of the data should be clearly indicated on the printout. If the source is magnetic tapes, disks, microfiche, film, or videotape, working papers should concisely explain the origin, contents, and use made of the data.
- (c) If an individual is the source of information, the auditor should provide the person's rank or grade; name; position title; telephone number; organization; and date, time, and place information was provided. **If the anticipated importance of the information is high, two audit staff members should participate in interviews, when possible,** and their names should be recorded in the working papers. Sufficient detail must be provided so that other persons, including persons not familiar with the audit, can easily identify and locate the source, if necessary.

- (2) Purpose of the working paper.** The purpose of a working paper is to show what the auditor accomplished in relation to a specific section or step in the audit program and/or to support a finding in the report.

⁷ In a multipage analysis, the "as of" date can be placed at the end of the analysis.

⁸ In a multipage analysis, the explanation of tick marks can be placed at the end of the analysis.

⁹ Every working paper need not include every element. It depends upon the type of working papers being prepared.

- (3) **Scope and methodology of the auditor's examination.** It is particularly important that the working papers show the volume of the transactions involved, the number examined, how and why tested transactions were selected, the period covered, what the examination consisted of (for example, comparison of data between different periods, or matching data to standards), and the extent of the auditor's verification of the quality and accuracy of automated data. When the analysis was based on a sample of transactions, information should be included to describe the sampling procedure used or to provide reference to a more detailed sampling plan contained elsewhere in the working papers. Required sampling data to be documented in working papers is discussed in paragraphs [606.1](#) and [832](#).
- (4) **Criteria.** The standards, policies, or other measurement the auditor used to support a judgment should be cited. Identifying the applicable regulations, directives, or instructions can often satisfy this requirement. As a general rule, only the cover sheet and the applicable portions of regulations/directives/instructions should be included in the working papers rather than copies of entire documents
- (5) **Conclusions or results.** What judgements has the auditor made after analyzing the data? These are the actual or potential adverse or positive effects that have been, or can be, expressed in dollars or mission impact. When the conclusions recorded on one working paper are based in part on information in other working papers, this fact should be noted and appropriately cross-referenced. If a conclusion is wholly an opinion of the auditor, this should be clearly indicated in the working papers.

3. Records of meetings. The results of all **relevant** meetings, including opening and closing conferences, should be recorded in the working papers -- either in control files or functional area or subject files. Such write-ups should state the purpose of the meeting, any discussions, attendees, and conclusions drawn, as well as the facts listed in the Handbook's guidance on working paper source (paragraph [506.2b\(1\)](#) applies).

4. Automated working papers.

- a. **General.** Although audit standards are the same for all working papers, there are unique requirements for using and preserving **relevant** working papers produced with computers. When audit work uses computerized techniques, including data processing and statistical programs, the step-by-step processes should be documented to permit repeat of the processes by third parties. Versions of the operating system and application programs used should be identified to allow validation of the audit processes despite future software revisions. Supervisory review of automated working papers as the audit progresses is essential in an environment where large quantities of data are being evaluated.
- b. **Required printouts.** Using professional judgment, auditors should print **relevant** automated working papers, except for large data files with thousands of records, and place them in the working paper files, where index numbers, cross-references, notes, explanations, and review comments can be annotated. These working papers will:

- (1) Reference the automated files from which they were generated.
 - (2) Describe versions of operating systems, application programs, utility programs, and telecommunications used.
 - (3) Describe formulas and computations used.
- c. **Large unprinted files.** For large **relevant** data files not printed, but which were downloaded and retained on tapes or diskettes, the working paper file will include summary information as to the storage location and contents of each tape or diskette (for example, the number of records and description of the fields), and cross-referencing to the related working papers and data extracts made using the file.
- d. **Graphs and charts.** The source data files for graphs and charts will be identified. Descriptions of graphic procedures used will be included in the working papers.
- e. **Storage of diskettes and tapes.** Diskettes or tapes should be cross-referenced to working papers and stored consistent with Naval Audit Service guidance for retention of working papers. In addition, they should each be write-protected and labeled with the audit job order number and title. When data is obtained from an audited command specific information must be provided on the external label. The following physical data specifications are required:
- (1) Job order number.
 - (2) Title.
 - (3) Labeled or unlabeled.
 - (4) Label name (if labeled).
 - (5) Record length.
 - (6) Blocked or unblocked.
 - (7) Block size.
 - (8) Data format (ASCII or EBCDIC).
 - (9) Tape density in bits per inch (BPI) (800, 1600, or 6250).
 - (10) Record layout showing all field sizes, any packed values, any signed values, and any assumed decimal places.
- f. **Additional requirements.** Other rules for automated working papers include:
- (1) Classified information may not be processed on computer equipment not previously certified for such use. Hard disk memory containing classified information should be

treated as if the equipment itself were classified until such time as all classified data has been purged from the memory. Details on the handling of classified working papers are provided in paragraph [512.3](#).

- (2) After entering data into automated working papers using manual key-entry or electronic transfer (downloading), auditors should verify and document that the transfer is complete and accurate.
- (3) When electronic worksheets are used, auditors should verify embedded mathematical computations with test checks and document the verification. All formulas used must be spelled out in the working papers.
- (4) At reasonable intervals during an audit workday, automated audit working papers should be copied (backed up) on separate diskettes or tapes. Daily copies should be stored separately as backup to reduce the risk of accidental loss. Project Managers will provide instructions for periodic backup of automated working papers.
- (5) When using automated data base management systems, auditors should retain a copy of the portion of the data base downloaded for use, on tapes or diskettes, as it existed at the time of the queries, as well as copies of the specific queries that were used to develop the audit results. Without this information, the logic of the queries and resulting observations may be impossible to recreate, if needed for supervisory review or support for audit conclusions and recommendations. The Audit Director can approve exceptions to this requirement, but justification must be documented in the working papers.
- (6) Unique computer programs written for an audit will be printed and placed in the working paper file unless those programs are retained on diskettes or tapes.

507 -- WORKING PAPER FILES

As part of the overall plan for each audit, the Project Manager shall provide instructions to all assigned staff covering working paper file structure, indexing, and cross-referencing procedures.

1. Working paper file covers. The cover of each working paper file should be clearly labeled to show:

- a. Audit title and job order number.
- b. Name of activity and location, program, or function being audited/ reviewed.
- c. Index symbol or number of the file itself.¹⁰
- d. Audited/reviewed area.

¹⁰ To be assigned by the Project Manager.

- e. Security classification if other than unclassified. Paragraph [512.3](#) discusses the handling of classified working papers.
- f. If applicable, a notice that working papers in the file require special handling because they contain proprietary or personal data. Paragraph [512.2](#) discusses handling of Privacy Act and proprietary information.

2. Functional area/subject working paper sections. A section for each of the functional areas or subjects should contain:

- A table of contents.
- Audit programs for the pertinent sections completed and cross-referenced to supporting working papers. Paragraph [509](#) discusses cross-referencing
- A working paper summary.
- Exhibits; notes; procedural write-ups; charts; forms; excerpts from laws, instructions or directives; reports; significant comments by activity personnel; and any other data supporting findings, recommendations, and audit work performed.
- A description of the extent and method of sampling. Paragraphs [606.1](#) and [832](#) discuss the elements required to describe auditors' statistical sampling work. Discussions with technical experts on sampling will be documented in the working papers.
- Completed [Working Paper Review Sheets](#) or other evidence of supervisory review (paragraph [510](#) applies).

a. Working paper summaries.

(1) General.

(a) For each audited area, auditors will prepare narrative summaries that are keyed to each audit program step or group of steps. They should sum up in a clear, concise, and convincing manner the work done, the results achieved, the conclusions reached, and the recommendations made, if any. Summaries assist in (1) controlling and administering the audit, (2) automating the working papers in a manner that facilitates efficient and effective navigation through the working papers, and (3) reporting. They should be developed as the audit progresses. **An audit finding can be the summary if it fully encompasses the audited area and can be keyed to an audit program step or group of steps.**

(b) When a series of working papers is developed for the same purpose and from the same source, the information should be summarized in one of the papers of the series.

- (c) Because of the diverse objectives and scope of audits, each summary should be tailored to the needs of the work segment. Although no specific format or style is prescribed, it should lend itself to preparing the final report. Summaries *must* be cross-referenced to the underlying working papers in accordance with paragraph [509](#). Copies of draft findings, cross-referenced to supporting working papers, can be incorporated into the summaries to explain the deficiencies or noteworthy accomplishments the draft findings cover. This eliminates the need to duplicate information in the summary and the draft finding.
 - (d) Audit supervisors should ensure that summaries are completed when the work in an area is completed, and should carefully review these summaries. Supervisory comments, including the need to redo summaries, should be documented (paragraph [510](#) applies).
- (2) **Content.** Each summary should concisely state what was completed relative to what was planned. It should provide a factual summary of the evidence obtained and may include tabulations and schedules. Paragraph [504](#) contains pertinent information about categories of evidence. Each summary should include a reference to any resulting draft finding(s). **Depending on the circumstances, auditors should either state the reasons for not performing intended work or delete the audit program step requiring the work.** If no deficiencies are found, that information should also be summarized for the record.
- b. **Working paper sections.** A control or "summary" working paper section will be organized to contain:
- (1) A copy of the DAMIS Project Detail Report as of the final report publication date.
 - (2) An overall table of contents or master index identifying all working paper files.
 - (3) A table of contents for the control file itself.
 - (4) A copy of the final audit report cross-referenced to supporting working papers, and, where applicable, certified as having been referenced by an independent person. Paragraph [511](#) discusses referencing.
 - (5) Copies of the initial and any later versions of draft audit findings and draft reports submitted to the activity, with the latest versions cross-referenced to supporting working papers, and the latest draft report certified as referenced by an independent person.
 - (6) Copies of all management responses received during audit utilization.
 - (7) Narratives explaining who attended the entrance and closing conferences (both auditee and Audit Service personnel), what was discussed, and what was agreed to.
 - (8) Narratives, exhibits, and schedules of a background or general nature.

- (9) Approved audit program(s).
- (10) A copy of the audit announcement letter.
- (11) A cross-referenced copy of the research/survey debriefs.
- (12) Completed [Working Paper Review Sheets](#) or other evidence of supervisory review including any comments/direction received from the Audit Director and/or Assistant Auditor General on findings, recommendations, and other matters (paragraph [510](#) applies).

508 -- INDEXING WORKING PAPERS

1. General. All working papers should be properly indexed. The principal purposes of indexing are: to make it easier to reference one working paper to another, to prepare summary analyses and reports, and to indicate the relationship of working papers to the particular areas or segments of the audit and to the related audit program step(s).

2. Methods. No standard indexing system is prescribed for working papers because of the diversity of our audits. However, the Project Manager should use the following criteria when devising a working paper indexing scheme.

- a. The indexing system should be established as part of the audit research/survey and be tailored to the overall focus of the audit, the selection of areas for emphasis, and the planned sequence. By following the planned audit approach, the indexing system should permit ready reference to any working paper at any time.
- b. The system should ensure the logical grouping of interrelated working papers.
- c. The system should be simple and capable of expansion.
- d. Every working paper should be numbered and each working paper page should be identified at the bottom by a section letter and a consecutive number within the section. The first page of each section -- the table of contents -- should show the title of the section and the letter used to designate that section (such as: A - General; B - Finance).

509 -- CROSS-REFERENCING

1. General. The development of an audit report is an evolutionary process, including detailed supporting working papers, analyses, summaries, findings, and a draft report. Cross-referencing at each step is essential to ensure that the auditor's position is supported. This reduces the risk of issuing a defective final report. At a minimum, working papers should be cross-referenced to:

- Other related working papers.
- The relevant audit program step or group of steps.

- The summaries.
- The draft and final reports.

All facts and mathematical computations in draft and final reports must be cross-referenced. Changes to or corrections of supporting information should also be referenced to other affected sections of the working papers. Sufficient time should be planned to ensure that both cross-referencing and indexing of working papers are completed before the final working paper review is accomplished and the auditors are released.

2. Responsibilities.

- Auditor.** The auditor performing the work is responsible for cross-referencing **relevant** working papers to each other and to the relevant audit program step(s), summary sheets, and findings, when appropriate. The auditor is also responsible for cross-referencing all pertinent narrative statements and statistical schedules in a draft finding to audit working papers.
- Project Manager.** The Project Manager must ensure that the draft audit report is cross-referenced to the supporting working papers. If report revisions are required as a result of the command-reply and/or editing/referencing processes, the Project Manager is also responsible for ensuring that adequate explanations for significant revisions are documented and cross-referenced to the related working papers.
- Audit Director.** The Audit Director must ensure that a copy of the final audit report is cross-referenced to the supporting working papers. Generally, this involves ensuring that the cross-referencing on the draft report is transcribed to the final report and making spot checks of the working papers to verify the accuracy of the cross-referencing.

PART III -- REVIEW

510 -- SUPERVISORY DIRECTION AND REVIEW OF WORKING PAPERS

1. Purpose. *Supervision is the first and most important aspect of ensuring audit quality, timeliness, and efficiency.* Supervisors **must** be involved in every phase of the audit and should make sure that the staff understands, without ambiguity, the nature, scope, content, and timing of the work assigned to them and the expected end product. The objectives of supervisory direction and reviews of working papers are to ensure:

- Working papers are prepared in accordance with GAGAS as implemented in the Naval Audit Handbook, [Chapter 5](#).
- Work is performed in accordance with the audit program and Project Manager direction.

- Work remains focused on the audit objectives and the audit findings.
- Work in nonproductive audit areas is curtailed in a timely manner.
- Overdocumentation is identified and preempted in a timely manner.
- Review objectives are fully covered in a timely fashion or additional work required to complete review objectives is identified.
- Evidence obtained is commensurate with the audit program guide, potential findings, or other report section to which it relates.
- Audit conclusions are valid and fully supported in the working papers.
- Security and privacy act standards are followed.
- Working papers are appropriately indexed and cross-referenced.
- Effective on-the-job training is provided.

2. Supervisory Direction. Supervisory direction is necessary for successful completion of audits. Evidence of direction must be included in the working papers. [Working Paper Review Sheets](#), e-mails and minutes or notes detailing meetings with audit staff are examples of such evidence. *Optional [Supervisory/Working Paper Review Sheet Items/Content](#) are included in the linked document.*

3. Scope of Review of Working Papers. The degree of supervisory review required depends on the skill level of the staff assigned to the audit, the complexity of the review, and the amount of day-to-day supervision provided. *It is expected that, at a minimum, working papers referenced in the audit report will be reviewed.*

4. Responsibility for Reviewing Individual Working Papers. The Project Manager, or a senior experienced auditor assigned by the Project Manager or Audit Director, should review individual working papers. Including the reviewer's initials or signature and the date of the review on the working papers must evidence the review. *Under no circumstances can the reviewer be the auditor who prepared the working paper.*

5. Responsibility for Reviewing Working Paper Folders. The Project Manager should prepare and include in most working paper folders a [Working Paper Review Sheet](#). The review sheet (or a similar automated working paper review form) that provides for documenting supervisory comments, actions taken in response to the comments, and the reviewer's acceptance of the comments, *must* be used. Whatever form of documentation is used to provide the results of supervisory review, subordinates *must* respond in writing to indicate specific actions taken and when those actions were taken. Also, there *must* be some indication in the review documentation that the reviewer accepted the subordinate's response. A supervisor's initials and date next to each completed action will be sufficient to indicate that the action taken was acceptable. *The absence of written evidence of supervisory review will be considered strong evidence that there was an absence of supervision. It is expected that supervisory review*

sheets will usually be completed throughout the course of the project, and not just at the project's conclusion. There may be limited occasions, such as in the case of a very short one or two month project performed by one or two experienced auditors, where it may not be practical or necessary to perform a supervisory review until the completion of the project's field work. As part of the review of the working papers folders, the Project Manager should assure that documents not germane to the audit are removed from the working paper folders. Also, reasons for not including a draft finding in the draft or final report must be documented in the working papers.

6. Audit Director's Responsibility. To the extent considered necessary, the Audit Director should review working papers supporting unusually sensitive findings and conclusions. Also, the Audit Director should place emphasis on work performed by the PM. Any review performed should be documented in the working papers *by initialing and dating all working papers reviewed and by preparing supervisory [Working Paper Review Sheets](#) (or similar automated working paper review forms).*

7. Assistant Auditor General's Responsibility. The Assistant Auditor General must approve and document a decision not to include a draft finding in the final report.

511 – REFERENCING

1. Definition. *Referencing is an independent examination and verification of the quality of a report and related audit work used to support the report.* It is a portion of the quality control program of the Naval Audit Service intended to help ensure that the contents of reports are factually accurate and adequately supported in terms of the sufficiency, competency, and relevancy of evidential material. It also helps ensure audit conclusions and recommendations are logical and reasonable. It differs from cross-referencing, a process to index a report to working papers and to index working papers to other working papers. Referencing involves verifying that all reported facts, figures, and references identified for referencing by the Assistant Auditor General, or his/her designee, are accurate as stated. Logical and reasonable paraphrasing and interpretation of items, other than facts, figures and dates, is allowed as a matter of risk management rather than word-for-word matching between the report and working papers.

2. Policy. *Referencing will be performed on all the facts, figures, logic, and criteria included in the report which are selected for referencing by the Assistant Auditor General, or his/her designee.* The Assistant Auditor General will review the report and highlight those facts, figures, logic, and criteria that require referencing.

a. Referencing is to be:

- (1) Performed by a person who was not directly associated with the audit work and who is not subordinate to the Audit Director responsible for the audit.¹¹
- (2) Conducted in addition to, and not in place of, supervisory reviews (by the Project Manager/Audit Director) of reports and working papers.

¹¹ *Exceptions to this policy will be approved by the responsible Assistant Auditor General.*

- (3) Initiated *after* the Audit Director has ensured that working papers are in order and that the draft report is accurate, complete, and properly cross-referenced to working papers.
 - (4) Completed prior to the issuance of the draft, final, and other types of reports.
Referencing of the final report only needs to address those areas where the draft report was significantly changed after draft report referencing.
- b. Reports being forwarded to the responsible Assistant Auditor General for either pre-utilization or pre-publication reviews *must* include a certification that all facts, figures, logic, and criteria selected for referencing by the Assistant Auditor General, or his/her designee, are correct. **The [Report Referencing Certification](#) is required prior to report utilization and prior to publication if the report was significantly changed after draft report referencing.**
 - c. Referencing results are to be provided directly to the responsible Audit Director with a copy to the Assistant Auditor General.
 - d. The responsible Assistant Auditor General will ensure that concerns raised by the referencer are appropriately addressed by the responsible Audit Director/Project Manager. The responsible Assistant Auditor General will not approve further processing of a draft or final report until satisfied with actions taken.
 - e. The referencing guidesheet, the completed review sheet, and the [Report Referencing Certification](#) are to be retained in the working paper files. Referencers will certify that corrective actions taken by the Audit Director/Project Manager are adequate. Disagreements with referencer comments that are not resolved by the Audit Director will be resolved by the responsible Assistant Auditor General and so noted on the [Referencing Review Sheet](#) before further processing of a draft or final report.
- 3. Characteristics of a referencer.** A referencer should possess the following characteristics.
- a. **Independence.** The referencer should not be directly associated with audit work on which the report is based. Furthermore, the referencer should not be subordinate to the Audit Director responsible for the audit being referenced.
 - b. **Proficiency.** The referencer should have knowledge of auditing methods, techniques, standards, categories of evidence, and reporting policies.
 - c. **Experience.** The referencer should have at least 4 years of auditing experience. Normally, GM 511-13s should be assigned as referencers. However, the referencer must be at least a GS 511-12.
- 4. Process.** Referencing will be achieved through the following procedures, which apply equally to draft and final audit reports.

a. Initiating referencing.

- (1) The responsible Assistant Auditor General is responsible for all referencing. The Assistant Auditor General assigns the referencer. After reviewing the draft or final report (as necessary), the Audit Director will present the report to the assigned referencer for referencing. Ideally, referencing should be accomplished after the draft report has been edited.
- (2) The responsible Assistant Auditor General will consider the complexity and geographic location of the working papers and will designate an independent auditor or auditors to perform referencing. On an exception basis, an auditor or auditors assigned to the Audit Director responsible for the report being referenced may be designated as referencers. Such exceptions should be rare and the reasons should be fully documented in the working papers. As a general rule, personnel performing independent referencing will be trained prior to performing independent referencing. Exceptions may be approved by the Assistant Auditor General.
- (3) Before beginning the actual referencing, the referencer should make a preliminary review to ensure that the draft is cross-referenced and the working papers have had the required supervisory review (i.e., completed [Working Paper Review Sheets](#) or other documentation indicating that the supervisor is satisfied with the contents of the draft report and working papers). If the draft has not been cross-referenced or completed supervisory reviews have not been documented, the referencer will note the situation on the [Referencing Review Sheet](#) and contact the responsible Assistant Auditor General who designated/approved the referencer. The responsible Assistant Auditor General will determine whether or not the referencer should continue. The referencer will document this decision on the review sheet.

b. Referencing tools.

- (1) [Referencing Guidesheet](#). A suggested referencing guidesheet has been developed. The referencer will use this guidesheet to the extent specified by the Assistant Auditor General during the referencing process. The guidesheet notes specific issues the referencer might consider throughout the report, and also lists a number of key issues the referencer might consider regarding the working papers. For each issue, the referencer needs to simply check either the "yes" or "no" column. Some questions on the guidesheet *may not* be applicable to the audit being reviewed. By the same token, the referencer *should not limit* himself or herself to considering only the questions in the guidesheet if the Assistant Auditor General specifies otherwise.
- (2) [Referencing Review Sheet](#). The referencer will fill out a Referencing Review Sheet identifying specific problems found. The referencer will identify specific opinions, conclusions, recommendations, and monetary benefits that are not supported, reasonable, or consistent with the facts. The referencer will also note specific factual errors. When appropriate, the referencer should note whether a deficiency is a pattern or an exception.

c. Performing referencing.

- (1)** *The referencer must check all facts and figures in the report, which have been selected for referencing by the Assistant Auditor General, or his/her designee, against the supporting working papers and not just to working paper summaries.* This part of the referencing is essential, since just one error can ruin the credibility of the entire report. Facts and figures include all quantities, dollar amounts, contract numbers, dates, quotations, and the identification numbers of laws and regulations. The referencer should place a tick mark on each checked word or figure in a report. The referencer will evaluate whether the paraphrasing and interpretation of laws, regulations, and policies in the report are consistent with extracts or copies of the actual laws, regulations, and policies in the working papers. Word-for-word referencing is not required, unless it is a direct quote. Facts and figures mentioned in more than one section of the report should match.
- (2)** If oral information is of key importance, the referencer should determine whether statements were corroborated (paragraph [504.4](#) applies). When appropriate, the referencer will assure that the report contains a clear statement that such information was not verified during the audit.
- (3)** For computerized data, the referencer need only verify that general and application controls were reviewed or other reasonable (professional judgement) tests and procedures were conducted when such data are an integral part of the audit. When computerized data are cited only for background or informational purposes and is not significant to audit results, only the source of the data need be verified within the working papers.
- (4)** The referencer will note when he or she has not checked a fact to supporting working papers and the reasons why (for example, the referenced source is not identified or contained in the working papers). The referencer will ensure that the classification of the report is consistent with the classification of the pertinent facts and figures in the supporting working papers. However, the referencer will note on his or her review sheet that source verification of security classification was not performed.
- (5)** The referencer's time will be charged to the job being reviewed.
- (6)** The referencer will provide his or her comments to the responsible Project Manager on the [Referencing Review Sheet](#)(s). The referencer will also provide a signed [Report Referencing Certification](#) that: all logic, facts, figures, criteria, conclusions, and recommendations identified for referencing were reviewed/referenced; and all problems identified were included on the Referencing Review Sheet(s).
- (7)** The Project Manager addresses the referencer's comments, indicating agreement or disagreement and the basis for any disagreement in the resolution section of the [Referencing Review Sheet](#). If additional support is provided or the report changed to address the referencer's comments, the Project Manager should indicate the working

- paper cross-reference on the Referencing Review Sheet. The referencer must check these new cross-references for accuracy.
- (8) When the responsible Audit Director is satisfied with the resolution of the concerns raised by the referencer, the Audit Director and the referencer will: document agreement by initialing and dating the appropriate line on the [Referencing Review Sheet](#) for *each* comment. In addition, the Audit Director will sign and date the appropriate portion of the same [Report Referencing Certification](#) form signed and submitted by the referencer. The responsible Assistant Auditor General will sign the referencing certification upon acceptance/ completion of all referencing. The certification will be placed in the working papers.
 - (9) If additional source material is provided in response to referencer comments, the Audit Director will ensure that appropriate cross-references are added to the draft or final report.
 - (10) Audit Director disagreements on **material** referencer comments will be reviewed and resolved by the responsible Assistant Auditor General before issuing the draft report. **All referencer comments must be resolved before report publication.** Referencers will certify their satisfaction with corrective actions taken by the Project Manager/ Audit Director and the resolution actions taken by the responsible Assistant Auditor General in those instances where the Project Manager/Audit Director and referencer disagree.
 - (11) If substantive changes are made to a draft report following referencing -- either as a result of referencing or due to other circumstances -- the report may need to be referenced again. The responsible Assistant Auditor General determines if re-referencing is necessary and to what degree. Individual facts and figures that have not changed can be marked with a new tick mark to indicate verification to the previous referenced product.
 - (12) Assistant Auditor Generals are required to note trends and systemic problems identified during referencing, take corrective action, and report these trends and systemic problems, along with recommendations for improvements, to the Policy and Oversight Division.

PART IV -- ADMINISTRATIVE TASKS

512 -- SAFEGUARDING

Precautions should be taken to safeguard working papers, including microfiche, computer tapes or disks, and microcomputers with stored information. This includes ensuring that they are accessible only to authorized persons and protected from theft or destruction.

1. Missing, lost, or stolen. When working papers become missing, lost, or stolen, the following procedures are to be followed:

- a. The building manager or security personnel where the working papers were before they were lost or stolen should be notified immediately so they can take the appropriate action.
- b. The responsible Project Manager should be notified immediately. The Project Manager will orally notify his or her immediate supervisor and follow up with a memo containing facts pertaining to the incident, including:
 - (1) The approximate date and time of the disappearance.
 - (2) How the theft, if any, was accomplished, if known.
 - (3) The parties notified of the incident.
 - (4) Investigative or corrective actions taken.
 - (5) A description of the missing working papers.

A copy of the memo should be sent to the responsible Assistant Auditor General. A followup memo should be prepared at the conclusion of all investigations.

- c. If missing working papers are not found, the Project Manager must determine what, if any, work has to be redone. The Audit Director, considering such factors as audit status, significance of findings involved will approve this determination, and remaining supporting evidence, such as other related working papers and referenced copies of draft reports. Approval by the Audit Director will be documented in the working papers.
- d. The responsible Assistant Auditor General will report missing, lost, or stolen working papers and the results of the investigation and corrective action to the Auditor General.

2. Personal and proprietary data. Working papers containing personal information (such as names or social security numbers of individuals) and contractor or proprietary information will be safeguarded to prevent unauthorized disclosure. Contractor or proprietary information consists of information that is submitted to an agency as part of or in connection with a bid or proposal. There are few clear cut, overarching rules regarding what may constitute contractor confidential financial or proprietary data in a specific case. Generally, information available to the public is not considered confidential. Examples of publicly available information might include commercial price lists, the type of item being purchased, and the contract price. Protected items might include profit margins, overhead and labor rate, manufacturing processes, proprietary methods of performance, information which is marked by the contractor in accordance [with FAR 52.215-1\(e\), etc.](#) Also, budgetary data that has not yet been publicly released by the President to the Congress should be safeguarded. The cover of each working paper folder containing such information will display the following statement – preferably in red:

SENSITIVE DATA: THIS FILE CONTAINS IDENTIFIABLE PERSONAL OR PROPRIETARY DATA. SUCH INFORMATION IS TO BE RELEASED ONLY TO AUTHORIZED PERSONNEL HAVING A NEED TO KNOW FOR OFFICIAL USES. WHEN NOT IN USE THE ATTACHED IS TO BE STORED IN A LOCKED CABINET OR SECURED ROOM. WHEN NO LONGER NEEDED THIS DATA SHOULD BE DESTROYED BY BURNING OR SHREDDING.

To reduce the need to secure voluminous files, personal and proprietary data may be withdrawn from individual working paper files and handled separately in secured files. The source file must contain a cross-reference as to where the data is located. A single working paper sheet may be used to list the indexed pages that have been removed.

3. Classified working papers. Precautions to be taken with classified working papers are:

- a. Classification markings and cover sheets must be used.**
- b. At the end of the audit, or sooner if possible, original copies of classified source information should be returned to the source.**
- c.** Paraphrasing, restating, or summarizing classified information may or may not change the level of or remove the basis for classification. When in doubt, auditors should consult the designated security official at the audited activity, or the office that classified the original document for a specific determination. The Naval Audit Service does not have original classification authority. Paragraph [618.1b](#) provides related information.
- d. Classified working papers must be stored in General Services Administration-approved security safes.** Additionally, these working papers must be stored separately from unclassified working papers.
- e. All electronic files will be classified and controlled/stored consistent with the highest level of classification assigned to the material.** Classified or sensitive data should be extracted from electronic files for separate storage, when practical, and if it will not damage or disrupt the remainder of the file (for example, cause a spreadsheet to recompute erroneously).
- f. The index of working papers for a particular audit should identify all classified working papers.**¹² A narrative sheet should be included at the appropriate location in specific working paper folders to advise where extracted classified working papers are located. To the extent possible, information on such narrative sheets should be developed in a manner to avoid the need to classify the sheets. Additional precautions are discussed below.
 - (1) Security education.** Project Managers are responsible for ensuring that personnel under their supervision are familiar with the security requirements for their particular assignments and the procedures to be followed when potential compromises or security violations are suspected or known.
 - (2) Marking.** Classified material will be physically marked in accordance with the procedures in [SECNAVINST 5510.36](#). All classified material, including third-party

¹² *If classified data is recorded on tapes or disks, the level of classification should be included on external labels and in electronically stored header information as a further precaution to avoid unnecessary disclosure to personnel without a need to know.*

proprietary information, shall be marked in a manner that leaves no doubt¹³ about: the level of classification assigned to the material, which parts contain or reveal classified information, how long the material must remain classified, and any additional measures necessary to protect the material. The SECNAV Instruction must be followed *explicitly*.

- (3) **Subjects and titles.** Whenever possible subjects or titles of documents will be unclassified. If a classified subject is necessary, add an unclassified short title for reference purposes.
- (4) **Reproduction.** Only reproduction equipment designated to reproduce classified material may be used.
- (5) **Safeguarding.** Specific instructions for safeguarding classified material are contained in [SECNAVINST 5510.36](#), Chapter 7. Classified information or material will be used only where facilities are adequate to prevent unauthorized persons from gaining access to the classified information. During working hours, when classified documents are removed from storage for working purposes, they are to be kept under constant surveillance and face down or covered when not in use. Classified information should be discussed only when unauthorized persons couldn't overhear. Protection should extend to preliminary drafts, working papers, notes, typewriter or printer ribbons, magnetic tapes, disks, disk packs, and other similar items containing classified information, including third-party proprietary information. When such items are no longer required, and are not to be returned to the original source, they should be destroyed by an approved method. SECNAVINST 5510.36, Chapter 10, has specific procedures for declassifying or clearing automated media.
- (6) **Handling and disposing.** Specific instructions for handling and disposing of classified material are contained in [SECNAVINST 5510.36](#).

513 -- RETENTION

For retention considerations, there are two basic types of working paper files: permanent and current.

1. Permanent. Materials contained in the permanent file should be of a continuing or recurring nature and useful in future audits of a particular program, system, function, or activity. Background data obtained during a survey, correspondence with an activity (for example, risk assessment), and prior audit reports are the type of material that should be included in this file. Unnecessary or outdated material should be purged during periodic updates of these files. The comprehensiveness of permanent files is a matter of professional judgement exercised at the responsible Assistant Auditor General level.

2. Current. Current working paper files, set up for each audit, contain the working papers developed during that particular audit. Current working paper files will be disposed of 3 years

¹³ *Third-party proprietary working papers and resultant reports will be marked "For Official Use Only."*

after the date of report publication or 2 years after all recommendations are closed, whichever is later. Retention of working papers for any audit in excess of 5 years requires the written approval of the appropriate Assistant Auditor General. The responsible Audit Director must ensure that there is no need for any portion of the files beyond the holding period. This determination should include contacting the SR Directorate to ensure all findings have been "Closed". The responsible individual should also ensure that sensitive personal data and proprietary information are destroyed by shredding or burning. All other working paper disposition, with the exception of classified data, which is covered [under Secretary of the Navy Instruction 5510.36 \(Series\)](#), will be in accordance with [Secretary of the Navy Instruction 5212.5 \(Series\)](#).

514 -- USE OUTSIDE THE AUDIT SERVICE

1. Authority. Secretary of the Navy Instructions [5740.25](#) and [5740.26](#) pertain to relations with the Department of Defense Inspector General and the General Accounting Office, respectively, and provide for "access to information."

2. Applicability. As a general rule, Department of Defense Inspector General and General Accounting Office representatives will be given access to information in audit files and working papers for **completed** audits. However, in any instance where there appears to be an abuse of this access, such as a "fishing expedition," access will be granted only after approval by the responsible Assistant Auditor General. Access to working papers for reports with restricted distribution, such as classified reports or sensitive pre-award procurement reviews, should be made only after coordination with the Assistant Auditor General for Strategic Sourcing and Resources Management. Paragraphs [104.1](#), [309.1](#), and [515](#) have related comments.

3. Releasing working papers. Only the Auditor General of the Navy can approve the release of audit working papers outside the Department of the Navy. When such approval is given, copies of the released working papers will be retained and an inventoried receipt will be obtained for the working papers released.

- a. Working papers related to draft reports will not be released, nor access to working papers granted to anyone outside the Department of the Navy without Auditor General of the Navy approval. Any authorized release will be documented in the working papers.
- b. Original working papers may be released to a Department of the Navy organization only when approved by the responsible Assistant Auditor General. In such circumstances, an inventory will be prepared and written receipt obtained. The receipt will state that the working papers will be maintained intact and returned at a specified date, or upon demand. A decision on the need to retain copies of the original working papers to be released will be made by the responsible Assistant Auditor General.
- c. Assistant Auditors General have authority to release copies of working papers to the audited activities and superiors in command during an audit. This authority may be delegated to responsible audit supervisory personnel. To reduce duplication of effort, auditors should release **copies** of audit working papers related to management control reviews when requested by audited activities. In such cases, the audited activities shall

be advised that the working papers were prepared for audit purposes only and may not fully satisfy documentation requirements for management control reviews. Releasing copies of working papers will be documented in the working papers.

515 -- TRANSFERRING WORKING PAPERS

Working papers are sometimes transferred to and from audit offices. When this occurs, the sending office should prepare a list of the transferred files as an enclosure to a transmittal memo sent with the files to the new location. The sending office will keep a copy of the list. The receiving office will confirm receipt of the files with the sender by returning a receipted copy of the list. First Class, certified mail, return receipt requested, will be used when mailing working papers. Classified and business sensitive working papers will be handled in accordance with [Secretary of the Navy Instruction 5510.36](#).

516 -- INFORMATION FOR FUTURE AUDITS

- 1. General.** Information files may be maintained to accumulate information necessary or helpful for planning and performing future audits. Such files must be kept in an orderly fashion and be periodically purged of information no longer pertinent or valid. The form and content of the files will vary depending on the type of future audit anticipated.
- 2. Information files.** Maintaining information files for future audits should aid in developing Project Planning Worksheets. The file might include copies of important newspaper clippings and Department of Defense public announcements related to programs, functions, and systems at a particular location and any additional data considered appropriate.

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PART I – AUDIT VERIFICATION

601 -- DEFINITION

During the audit verification phase, auditors verify the existence and determine the cause of the potential problems disclosed during the audit research and/or survey phases and further determine the magnitude and impact of those problems and other problems that are subsequently identified.

602 -- ENTRANCE CONFERENCE

1. General. Prior to beginning the audit verification phase, professional judgement will determine whether the Audit Director or the Project Manager will offer a formal verification phase entrance conference to the commanding officer/program manager. However, survey results that change the audit objectives or scope will require holding a verification phase entrance conference.

2. Procedures.

- a. At the verification phase entrance conference, the commanding officer/program manager again will be informed of the purpose, objectives, scope, and planned duration of the audit. Results of the survey phase and any changes in originally planned objectives or scope will be discussed.¹⁴ Periodic briefings of audit progress should be offered.
- b. The audit process and the utilization process will be discussed. The commanding officer/program manager should be advised:
 - (1) That a draft report will be submitted electronically to the recommendation addressee(s) prior to the exit conference, with information copies provided to two echelons above the recommendation addressee(s) but no higher than the Assistant Secretary of the Navy level. Exceptions to the electronic distribution rule include classified reports and other reports with sensitive information.
 - (2) That repeat findings will be addressed to the immediate superior in command and not to the command level.
 - (3) That suspected fraud or other illegal acts might be reported to the Naval Criminal Investigative Service, dependent on the circumstances (paragraph [615](#) applies).

¹⁴ The same management levels that were initially advised on the audit objectives in the announcement letter must always be advised of a change to objectives or scope.

603 -- AUDIT PERIOD

The period of operations or transactions selected for audit should generally be as current as possible (normally within the last 12 months) and should be standardized for different audit areas to the extent possible.

604 – REQUIREMENTS: AN OVERVIEW

At the end of the survey phase, the Project Manager/Audit Director should have identified the potential audit finding(s) that may be reported and determined what has to be done to measure the full scope of the finding(s). The Project Manager should come out of the survey phase with an informal outline of the condition, criteria, cause, effect, and audit steps to fully develop the potential finding(s) and indicate how technical issues like statistical sampling will be addressed ([Part III of Chapter 4](#) applies). The Project Manager should have reasonable support for the finding condition and criteria but the cause and effect may be estimates or forecasts. **In the verification phase, the Project Manager fully identifies and supports the finding condition, criteria, cause, and effect.** At that point, the Project Manager must develop recommendations and formal [Finding Outline Worksheets](#), followed by complete findings, and ultimately the complete draft report. **As part of this process, the Project Manager must determine whether deficiencies noted are material weaknesses** (paragraphs [402.3](#) and [807](#) provide guidelines for determining materiality). **Material weaknesses must be specifically identified as material in the body of related finding(s).** If appropriate, the Project Manager will report nonmaterial weaknesses to management. Paragraph [815.4f](#) provides details on reporting nonmaterial weaknesses/findings.

605 – DEVELOPING AND ORGANIZING AUDIT FINDINGS

The Audit Director and Project Manager are responsible for developing and preparing the audit report in accordance with professional standards as detailed throughout this Handbook. From a productivity standpoint, the Project Manager needs to gather the necessary information and develop and organize the report content in a manner that will speed the writing, reviewing, referencing, and editing of the report. **Particular emphasis should be placed on the content and organization of audit findings.** Paragraph [421](#) discusses the process for developing the appropriate audit steps needed to gather all the necessary data in relationship to all elements of an audit finding, e.g., condition, criteria, cause, and effect. The [Finding Outline Worksheet](#) further aids in the identification and organization of the finding elements. [Part VI of Chapter 8](#) provides detailed guidelines concerning required audit finding content. **To meet professional standards and maximize productivity, it's essential that the Project Manager/Audit Director refer to the guidelines in paragraph [421](#) and [Part VI of Chapter 8](#) and that they use the [Finding Outline Worksheet](#) during the verification phase of each audit as findings are being developed and written.** Special emphasis should be placed on the identification of the underlying cause(s) of problems (paragraph [830](#) applies).

This stage of an audit provides the best opportunity to develop entry level (GS-5 through 11) personnel through on-the-job (OJT) training. The key skills of data gathering, interviewing, testing, corroborating, analyzing, interpreting, documenting, developing and drafting findings, and utilizing findings can be employed/taught. Auditor General direction entitled “[Development of Entry Level Personnel](#)” discusses this subject in greater detail. The linked article compliments OJT by helping the new auditor learn “[How to Think Like an Auditor](#).”

606-- AUDIT TECHNIQUES

1. Statistical sampling. Statistical sampling will be used when appropriate to improve the efficiency and effectiveness of an audit. The methods, techniques, and extent of sampling must be carefully planned to ensure meaningful examination results and conclusions and valid projections. Where appropriate, the Project Manager (PM) should consult with a technical expert early on (paragraph [309.3](#) applies). The PM will include specific guidance on the estimated population, confidence levels, sampling precision, the method of sample selection, and reporting of statistical sampling results in the Survey Debrief or related Audit Program. Projections of statistical sample results should be approved by the responsible Audit Director and documented in the working papers. **With rare exception, the mid-point will be used in statistical sampling for point estimates on performance audits.** The following additional guidelines apply:

a. Attribute sample.

- (1) The estimate of an *attribute* sample refers to a percentage, or the number of items, in the universe that contain the characteristic of interest. Thus, for a population size of 10,000, a statement that the auditors can be 90 percent confident that a certain estimate is 15 percent (mid-point error rate) plus or minus 5 percent (precision) is equivalent to saying that the auditors can be 90 percent confident that 1,500 plus or minus 500 items exist in the population.
- (2) To avoid any embarrassment and/or the need for additional travel funds to return to audit locations, the PM/AD should decide the issue of needed sampling precision in relationship to the planned use of sample results (and the related sample size), as soon as practicable.

b. Variable sample.

- (1) The precision of a *variable* (dollar value) sample refers to the confidence bound. Thus, for a certain population, a statement that the auditors can be 90 percent confident that a certain situation cost the Navy \$100,000 (mid-point), plus or minus \$9,000, could be expressed in subsequent remarks as a precision of 9 percent relative error.
- (2) In most variable sample results, the precision should *not* be looser than plus or minus 10 percent with a 90 percent confidence level.

2. Automated retrieval techniques. Where appropriate, automated retrieval techniques on mainframe computer systems should be used to select and examine computer-stored information. Most management information systems have an automated retrieval and report generator capability.

3. Micro-to-mainframe link. The volume of automated data files may be so large that manual analysis would require significant expenditure of resources. In these circumstances, audit-related information may be extracted/downloaded from the activity's/program manager's automated data files to the auditor's computer. The auditor can then examine the selected data.

4. Audit questionnaires. Audit questionnaires can be used to collect information. Questionnaire results may indicate that a problem or the perception of a problem exists. Questionnaire results should be validated by other audit tests to the extent possible. Use of unvalidated questionnaire results as the sole support for audit conclusions **MUST** be coordinated **in advance** with the responsible Assistant Auditor General. Generally, such use is **discouraged**.

5. Other techniques. Auditors can utilize any other recognized technique to gather and analyze data (such as regression analysis, labor estimating methods, work measurement methods, correlation analysis, improvement curve analysis).

607-- SUPERVISORY VISITS

1. General. Project Managers/Audit Directors must periodically visit audit fieldwork locations to review audit progress, discuss problems, and redirect efforts, when needed. The frequency of visits is a matter of professional judgement and should be based on the complexity of the audit, staff experience, and workload considerations.¹⁵

2. Attendance at exit conferences. As a general rule, the Audit Director should attend entrance and exit conferences (Commercial Activity Reviews and unannounced disbursing audits are exceptions to the general rule).

3. Change of command. A change of commanding officer/program manager during any audit requires the Project Manager to meet with the new person and provide a briefing on the objectives, status, and processing procedures associated with the audit. On significant audits, the Audit Director should normally attend such briefings.

608 – POTENTIAL BENEFITS

1. Policy. Auditors will determine the potential benefits (monetary or nonmonetary) that could result from audit findings and recommendations. Including estimates of potential benefits in the audit report helps the reader judge the importance of the condition and the recommended corrective action. Auditors' estimates are based on information available at the time of audit. Actual amounts realized may be affected by changing requirements, unforeseen costs, and other subsequent events and, therefore, may be greater or less than the auditors'

¹⁵ *In the absence of onsite visits, periodic guidance provided by e-mail or telephone should be documented and retained in the working papers along with the responses to such guidance.*

estimates. Two types of benefits exist: monetary and nonmonetary. Auditors shall identify, quantify, support, and report potential monetary and nonmonetary benefits associated with findings.

2. Examples of monetary benefits. Potential monetary benefits are classified as "Funds Put To Better Use." The term "funds put to better use" means that funds could be used more efficiently if management implements recommendations made by the audit organization. Examples include:

- Reduction in outlays.
- Deobligation of funds from programs or operations.
- Withdrawal of interest subsidy costs on loans or loan guarantees, insurance, or bonds.
- Costs not incurred by implementing recommended improvements related to the operation of the establishment, a contractor, or grantee.
- Avoidance of unnecessary expenditures noted in reviews of contracts or grant agreements.

3. Identification of benefits. Each finding and recommendation in an audit report should be considered in the following terms:

- a. Will the potential benefits (monetary or nonmonetary) claimed in the audit report result from management taking action to address the specific situations and recommendations that are included in the report? (If costs were unnecessarily incurred in the past but there is no assurance they will occur in the future, they should not be claimed).
- b. Are potential monetary benefits annual or one-time?
- c. Are potential monetary benefits reasonably measurable? Is there evidence of ongoing or planned procurements in the DOD Program Decision Memorandum (PDM), or the Program Objectives Memorandum (POM), whichever is most current, that could be affected? Each document covers a 6-year period.
- d. Did the auditors independently arrive at the conclusions reached to include appropriate validation of benefit information received from others?
- e. Are there readily identifiable offset costs? If so, have they been deducted in computing the net potential monetary benefit?
- f. If there will be a monetary benefit but the amount is too unpredictable to be estimated, is the amount properly reported as "indeterminable" or "immeasurable?"

4. Computing and claiming monetary benefits. Benefits from internal audits shall be computed whenever the benefits are due directly to the audit recommendations; i.e., the benefits claimed can be expected to result once management completes recommended actions. **Final estimates of monetary benefits that appear in audit reports will be rounded to three places.**

Estimates that are rolled up to comprise a final estimate will be consistently rounded to four places.

- a. **Offset costs.** The amount of gross monetary benefits claimable will be reduced by all offset costs. Offset costs include all direct or indirect costs that will be incurred in implementing the action that will result in the monetary benefits.
- b. **Budget projections.** Amounts claimed for both one-time and annual benefits may be based on budget projections. For both types of benefits, the amounts that may be claimed are limited to a 6-year period covered by the most current POM, DOD Program Decision Memorandum (PDM), or Future Years Defense Plan (FYDP). Up to seven years may be claimed if the POM, PDM, Or FYDP was approved in the year prior to its coverage AND the audit report is issued in the year prior to the 6-year period covered by the approved POM, PDM, or FYDP. The POM, PDM, or FYDP approval must be verified and documented in the working papers.
- c. **One-time or recurring benefit.** Many recommendations produce only a one-time benefit. Examples would be reductions in requisitioning objectives, return of funds erroneously paid out, or reductions of material requirements. There are instances when a one-time management action will result in benefits affecting several identifiable fiscal years, such as canceling plans to acquire major end items of equipment over a number of years or leasing rather than purchasing automatic data processing equipment. Certain recommendations result in recurring annual benefits that continue for an indefinite period of time. Examples would be reductions in payrolls and other operating expenses.
- d. **Benefits involving other activities.** Audit work within the Department of the Navy may result in benefits at another Department or Agency within the Department of Defense or the Federal Government overall. These benefits may be claimed in the report for the audit that produced the savings. The facts concerning such situations should be clearly described in the audit report. Reportable benefits must result in a net benefit to the Department of Navy, the Department of Defense or the Federal Government overall. For example, a reportable benefit would result when a recommendation to the Defense Finance and Accounting Service (DFAS) or any other DOD component or Federal agency results in a refund to the U. S. Treasury. Collections or reimbursements from other Federal organizations to either the Navy or the Marine Corps are reportable if they result in a net benefit from a DOD perspective. Intra-Defense collections or reimbursements, which result in "wash" transactions within the Department of the Defense, are not claimable.
- e. **Statistical sampling.** The use of statistical sampling to project monetary benefits is encouraged. When statistical sampling is used, benefits are normally reported within a certain range or at a midpoint within the range. **Under most circumstances, statistical reporting of monetary benefits should be based on the midpoint.** On an exception basis, use of a one-sided projection is authorized. **Use of one-sided projections must be approved in advance by the responsible Assistant Auditor General.** A one-sided projection may be more appropriate in cases where obtaining a midpoint projection within an acceptable range requires substantially more audit effort than a one-sided projection. However, **under no circumstances will an amount in excess of the**

midpoint be reported. Projections shall be limited to the sampled universe. Sample results will not be used to project monetary benefits outside the sampled universe.

- f. Extrapolating future benefits.** Auditors cannot make statistical projections of audit results to the future (e. g., outyears of the budget, Program Objective Memorandum, Future Years Defense Plan, Program Decision Memorandum) because they have not tested the future data. However, the results of statistical samples that tested current and/or past year data can be used as input to extrapolate future potential monetary benefits **within the sampled universe**. In doing so, sufficient historical data (at least 1 year) is necessary to document the tendency or trend of a continuing problem when estimating future benefits **within the sampled universe**. When making an extrapolation, auditors must ensure that adequate consideration is given to future budget data and other information available to decision-makers. **Extrapolations of monetary benefits should not in any way infer that they are statistical projections or should they imply statistical confidence or precision.**
- g. Indefinite recommendations.** Recommendations should be as specific as possible. **Recommendations to "consider," "reevaluate," or "make a study" are weak recommendations and, except in unusual circumstances, should not be made.** However, if such recommendations are made, any related monetary benefits will normally be too unpredictable to be estimated and claimed. If an indefinite recommendation is made and monetary benefits claimed, it must be clarified in the body of the finding why the monetary benefits are being claimed.
- h. Deobligation of funds.** So long as funds can be reprogrammed, they can be claimed. However, the total effect of the deobligation must be considered before benefits can be claimed. If funds are deobligated from one appropriation, customer, or fiscal year, resulting in creating new obligations of an equal amount of funds by another appropriation, customer, or fiscal year, then no benefits would be claimable as this is considered a "wash." Deobligation of expired account funds cannot be reported as potential monetary benefits.
- i. Independent audit verification.** The validity of potential monetary benefits must be ascertained independently by the auditors before the benefits can formally be claimed and included in the audit report; that is, the **auditors shall not accept an estimated benefit amount provided by management or another party without an independent validation as part of the audit process.** If auditors rely on benefit data provided by others, they must include documentation in the working papers addressing what they did to satisfy themselves as to the accuracy of the data.

5. Functional area considerations for monetary benefits. Some functional areas present unique problems on appropriateness and classification of benefits. Those areas are discussed in the following paragraphs:

- a. Military personnel.** Recommendations regarding military personnel authorizations and assignments usually do not affect military end strength. These recommendations generally are designed to remedy overstaffing at a particular location or to require use of

civilians instead of military to do a particular function. These benefits are normally reported as funds put to better use.

- b. Civilian personnel.** Recommendations sometimes result in reductions in personnel authorizations for an activity or organization. Generally, those spaces are transferred to other activities or organizations that were understaffed because of personnel or funding limitations. While these actions will not result in reductions of overall personnel strength for the component, the benefits still should be reported as funds put to better use.
- c. Material excesses.** Reports often contain recommendations to redistribute excess material to satisfy operating requirements or to fill inventory shortages. The determination of benefits will depend on what effect the redistribution action would have on current and future acquisition and holding costs.

(1) Audits of supply support activities often identify **stocks that are in excess of prescribed retention limits.** Redistribution of these stocks to other activities that have a current need can result in monetary benefits through canceling requisitions or planned procurements. It is not necessary to identify and cancel outstanding requisitions to claim potential benefits when it is demonstrated that material excesses exist. The audit, however, must demonstrate that the material excesses are demand supported; i. e., are active inventory items within the supply system. The rationale for this is an assumption that demand supported supplies have a higher turnover rate and are reordered within the current year or next 5 years following the completion of the audit. Potential monetary benefits will be based upon a 6-year demand. Therefore, on-hand quantities within the supply system must be determined and potential monetary benefits will be limited to no more than 6 years of demand. Variable inventory **holding costs**, such as investment cost, obsolescence and other losses, and storage costs associated with excess material can also be avoided.

(a) Investment cost. This is the cost to the U. S. Government for borrowing funds to buy inventory. If an audit describes premature Navy payments or other similar transactions, the cost avoidance is computed based on interest earnings lost rather than interest expense incurred. Therefore, our audit reports should state that the Navy actions resulted in interest earnings lost by the Treasury, without attributing any cost associated with Treasury borrowings. Treasury rates to be used will be identified annually by the Policy Division.

(b) Obsolescence and other losses. This is the cost of inventory losses due to technological obsolescence, material deterioration, inventory shrinkage, and pilferage. A loss rate based on past experience is normally used to calculate this cost.¹⁶

(c) Storage cost. This is the cost of keeping inventory onhand, i.e., the “holding costs”. It includes warehousing, physical inventory operations, preservation and

¹⁶ Auditors can either use the rate established by management after validating it or develop their own rate. As a general rule, standard rates in these areas are highly suspect because obsolescence/ loss costs vary depending on the material type.

packaging, and personnel costs. A monetary benefit may occur regarding holding costs when an audit reports excess material. The amount of holding costs depends on whether the material can be used to offset future procurements or will be sold/disposed. However, in some instances, determining accurate holding costs for audit purposes may not be practical in terms of the additional audit effort required to properly document these costs.

- If excess stocks are not authorized or qualified for stockage and the holding activity has no foreseeable future need for the items, monetary benefits would generally equate to the value of stock redistribution and the amount of inventory holding costs avoided by removing the items from storage and placing them into use. Holding costs for up to 6 years may be considered in this situation. Management generated holding costs or percentages need to be validated.
- In the case of authorized stockage items, the determination of monetary benefits should weigh the potential reductions in holding and current acquisition costs against the cost to the holding activity of replacing these stocks in the future. Stocks, which exceed computed economic retention limits, are not considered economical to retain. If onhand stocks exceed computed economic retention levels and are not being held for any other purpose, redistributing the stocks to satisfy current requirements would generally result in monetary benefits equal to the value of the stocks redistributed. Although the holding activity may have to replace these items in a future year, the replacement costs would be offset by reductions in holding costs. When retention limits are not computed on an economic item-by-item basis, the determination of monetary benefits from redistributing stocks that exceed prescribed retention limits should consider how long it would take to use the stocks in place, and whether potential reductions in holding costs would offset the costs to replace the items in the future.
- Another situation involves activities that continue to order stocks and to maintain an excess inventory. A recommendation to reduce ordering would result in funds put to better use if it can be assumed that the activity would have continued to order and maintain an excess position.

(2) Major equipment items (Major End Items) are centrally funded, procured, and managed at the Department of the Navy level, and is defined as any item that is not a secondary item. Examples of Major End Items include but are not limited to:

- Weapons and/or weapon systems.
- Military vehicles, aircraft, ships, or any stand alone system, that provide new or additional military capabilities or maintain existing capabilities, and normally fall under the heading of "Investments" in NAVCOMPT Manual, Volume 7, and are generally funded using Navy or Marine Corps procurement funds.

Procurement decisions are made at the Department of the Navy level based on the worldwide asset position. Those equipment items are accounted for on property books at the user's level and are also part of the centrally managed worldwide asset position. If procurement is based on the total Navy asset position, a distribution of local excess may not affect the net requirements or procurement decisions. Such distribution may improve productivity or readiness through better use of available assets. Unlike excess stocks or material, however, it is not enough just to demonstrate that equipment excesses are demand supported. An assumption cannot be made that equipment items are high turnover items that are likely to be procured frequently; i.e., during the current year and the next 5 years from the date of the audit. It would be necessary for the audit to demonstrate the effect excess equipment will have upon ongoing or planned procurements to claim the potential benefit, i. e., corresponding budget information must be included in the process. Budget information includes, but is not limited to, the most recent Program Objective Memorandum, Future Years Defense Plan, Program Decision Memorandum and their supporting documentation.

(3) If a recommendation is made to defer the procurement of supplies or an item of equipment, the deferment should be for at least 2 years to take credit for the monetary benefit.

d. Navy and Marine Corps Military Construction (MILCON) projects. The Congress, on a project line item basis, approves funds for Navy and Marine Corps MILCON projects. Generally, Congress approves specific projects on a 2-year cycle as part of a biennial budget. When recommendations are made to reduce in scope or cancel an approved, funded, or budgeted project, a potential monetary benefit may be claimed.

e. Nonappropriated funds. Benefits identified to nonappropriated funds, including the Navy and Marine Corps exchange organizations, can be claimed. However, care must be exercised to ensure that these benefits are properly described in audit reports so as not to imply that the benefits involve appropriated funds when that is not the case.

6. Nonmonetary Benefits. Many recommendations result in valuable benefits to Department of the Navy but cannot be expressed readily in monetary terms. Such benefits may accrue from recommendations relating to such areas as:

- Operational readiness.
- Equal employment opportunity.
- Security.
- Safety.
- Data accuracy.
- Environmental programs.

- Organizational structure.
- Rehabilitation programs.

These benefits should be reported through use of the most appropriate quantitative measurement in each instance. For example, higher operational readiness could be expressed in terms of increased numbers of units meeting readiness standards.

7. Reporting benefits.

- a. Audit reports shall indicate the amount of monetary or nonmonetary benefits that will accrue if the recommendations are implemented. The report shall contain a complete description of each monetary benefit to ensure that the reader understands the nature of the benefit and the basis upon which it was determined. The appropriation account and year of funds affected should be determined whenever possible and included as part of the discussion of the finding in Section B to aid management in taking corrective measures. Only the net amount of recurring potential benefits will be reported in Section C. This will normally require reporting "Various" or an appropriation with an unspecified year (e. g. 17* 1804) in the appropriation column of Section C.
- b. Auditors should reach agreement with management on the reasonableness of potential benefits cited in the report and document the agreement in writing. **Management is required by [SECNAV Instruction 7510.7\(Series\)](#) to specifically review and comment on the reasonableness of auditor estimated potential benefits as part of its review of the draft report.** If management does not specifically comment when responding to the draft report, management must again be asked to comment on the potential benefits in a response to the final report. If management nonconcurs with the auditor's estimate of the potential benefits, the amount may still be included in the final report if, after carefully considering management's comments, the auditor still believes the estimate is valid. The audit position must be defended in a rebuttal that supports the monetary benefits claimed. Ultimately, the matter must be resolved through the procedures specified in [SECNAV Instruction 5200.34\(Series\)](#).
- c. Auditor estimates of potential monetary benefits using statistical sampling methods are subject to the same provisions of [SECNAV Instruction 7510.7\(Series\)](#) as other estimating procedures. If management does not agree to estimates of potential benefits based on statistical sampling because the samples did not allow management to identify specifically the organizational entities that would realize the benefits, the auditors shall try to gain management's agreement with respect to corrective actions required and the validity of the sample on which the estimate of monetary benefits was based. The inherent accuracy of a projection based on a statistical sample may be accepted if the auditors can obtain management agreement on the underlying causes of the reported problem. Auditor estimates of potential monetary benefits based on statistical sampling procedures are subject to the same provisions of [SECNAV Instruction 5200.34\(Series\)](#) regarding the management response and decision process as are estimates of monetary benefits based on other estimating procedures.

- d. Discussions with management during the audit may result in changes and improvements in management operations resulting in actual or projected monetary benefits before the audit report is issued. **A record of these discussions should be part of the working paper documentation if the auditors claim that monetary benefits were realized based on their audit work. A record of the discussions that resulted in the potential benefits should also be included in the audit report; i.e., evidence to show that management took corrective action as a result of the audit.** In this situation, the monetary benefits should be claimed and included in Section C of the audit report.
- e. Potential monetary benefits that are too unpredictable to be accurately estimated must be reported as indeterminable/immeasurable. Estimated amounts may be included in the finding to quantify the potential savings but will not be claimed in Section C of the report.
- f. Before the draft audit report is issued, each potential monetary benefit shall be reviewed and approved by the Project Manager, Audit Director, and the responsible Assistant Auditor General. Also **before the draft report is issued, the Policy and Oversight Division (SR-2) will review and approve recommendations with monetary benefits exceeding \$10 million for logic and reasonableness. Such reviews will include ensuring that recommendations are properly categorized, i.e., “Open”, “Closed”, or “Undecided”.**

8. Maintenance of records.

- a. **Establishment.** A record of potential benefits (Section C of the audit report) shall be established for each audit by the time the draft audit report is issued. The record shall show for each recommendation in the report **the amount of potential monetary benefits**. If monetary benefits will accrue from a recommendation, but the amount is "indeterminable" or "immeasurable," that fact should be noted in Section C with an explanation of how the determination was made.
- b. **Details on computation.** Specific details on how each potential monetary benefit was computed and any exception taken by management shall be explained in the audit finding or a separate appendix to the report and the related working papers. Any changes agreed to during staffing and discussions of the draft audit report should be incorporated into the final report.
- c. **Followup system input.** Management comments received in response to claimed benefits after report publication shall be furnished to the SR Directorate, which is responsible for initially placing the potential monetary benefits in the followup system and updating the system based on receipt of additional management comments.
- d. **Cooperation with management.** Management often uses information on potential monetary benefits in the budget formulation process. The auditor shall cooperate fully in making such information available to budget personnel, including identifying appropriations affected by the benefits, if known. Potential benefits based on statistical sampling may present a special case. If the auditors and DON management agree that benefits will result but are unable to validate benefits by identifying organizational

entities that would realize the benefits, the auditors may still claim and report the benefits. Auditors should ensure that benefits based on statistical sampling are appropriately identified so activities/Commands are not unnecessarily subjected to inappropriate or unfair budget restrictions. Ultimately, however, a decision on whether or not a budget adjustment is made rests with DON management.

- e. **Monetary benefits agreed to and achieved.** The SR Directorate will maintain data on the benefits agreed to for comparison with benefits estimated on a report-by-report basis. Benefits are considered achieved when followup action verifies that command has taken the agreed to action.

609 -- CONCERNS FOR FINANCIAL AUDITS

1. General. The objective of an audit of financial statements is to express an opinion on whether the financial statements of an audited activity present fairly, in all material respects, the financial position, results of operations, and cash flows, in accordance with defined accounting principles. The auditor's report is the medium that expresses the opinion. The audit will be performed in accordance with government auditing standards (GAS) and supplemental bulletins issued by the Office of Management and Budget (OMB). Financial audit standards promulgated by the American Institute of Certified Public Accountants are incorporated into GAS by reference.

2. Financial audits.

- a. The Chief Financial Officers Act of 1990 (CFO Act), as amended by the Government Management Reform Act of 1994, requires annual preparation of financial statements for certain Government activities and an annual audit of these financial statements.¹⁷ The Federal Financial Management Act of 1994 and the Federal Financial Management Improvement Act of 1996 expanded required audit coverage. The Federal Accounting Standards Advisory Board establishes generally accepted accounting principles (GAAP) for Federal entities. The Department of Defense Financial Management Regulation (DOD 7000.14R) governs financial management by establishing and enforcing requirements, principles, standards, systems, procedures, and practices necessary to comply with financial management statutory and regulatory requirements applicable to the Department of Defense. Audits will be performed in accordance with GAS and supplemental bulletins issued by the OMB. This guidance requires that we plan and perform the audit to obtain reasonable assurance about whether the Principal Statements and Related Notes and Consolidating Statements if any are free of material misstatement. Auditors should ensure that they have, and comply with, the most recent OMB guidance. [Chapter 9](#) provides additional guidance on financial audit reports and financial statements.
- b. **Objectives.** Financial statement audits under the CFO Act will include the following objectives:

¹⁷ *Public Law 101-576, 15 November 1990.*

- (1) Determine whether the Principal Statements present fairly in all material respects, in conformity with generally accepted accounting principles, the assets, liabilities, and net position, net costs, change in net position, budgetary resources, reconciliation of net costs to budgetary obligations, and, if applicable, custodial activity.
- (2) Determine whether the reporting entity has an internal control structure that provides reasonable assurance of achieving the internal control structure objectives.
- (3) Determine whether the reporting entity has complied with laws and regulations that could have a direct and material effect on the Principal Statements.
- (4) Determine if the information and manner of presentation in Management's Discussion and Analysis, the Required Supplemental Stewardship Information, and Required Supplemental Information are materially inconsistent with the information in the Principal Statements.

3. Unique requirements. Consulting this Handbook cannot take the place of a careful reading of the underlying authoritative literature relevant to financial audits. The [Financial Audit Manual](#) published by the General Accounting Office is an example of authoritative literature. In addition, the Naval Audit Service favors a risk-driven vice a procedures-driven approach to financial auditing. The auditor should be aware that certain unique issues and audit procedures exist for financial audits that are not normally performed during performance audits. These include the following:

- a. **Audit Risk.** Audit (Ultimate) risk is the risk that the auditor will give the wrong opinion on the financial statements. It is a combination of the risk that material errors will occur in the accounting process by which the financial statements are developed and the risk that those material errors will not be detected by the auditor.¹⁸
- b. **Materiality.** Professional standards require auditors to make a preliminary judgement about materiality in the planning stage of an audit.¹⁹ Optional guidelines for "[Determining Materiality for Financial Statement and Financial-related Audits](#)" are provided in the linked document. Consideration must also be given to the volume of activity in an account when planning an audit. In this situation, percentage-type guidelines may not be applicable when the risk of fraud or waste is high.
- c. **Overview and Performance Information.** Auditors are responsible for identifying material inconsistencies between financial statements and overview/ performance information. They must understand the internal controls and assess the risk relative to the completeness and existence of performance measurement information included in the Management's Discussion and Analysis. In addition, the auditors must determine compliance with the CFO Act, the Government Performance and Results Act of 1993, and OMB implementing requirements regarding performance measures and overview information.

¹⁸ See SAS No. 82, paragraph 2 (AU312.02)

¹⁹ See SAS No. 82, paragraph 3 (AU section 312.03) and the *Government Auditing Standards*, Chapter 4, paragraphs 4.8 and 4.9.

- d. Management representation letters.** Auditors are required to obtain written representations from management as part of an audit, and to provide guidance concerning the representations ordinarily obtained.²⁰ The specific written representations to be obtained depend on the circumstances of the audit and the nature and basis of the presentation of the financial statements.²¹ The request for a management representation letter should be made as soon as possible after the end of the period subject to audit. Because the auditor is concerned with events occurring through the end of field work, i.e., date of the draft audit report, that may require adjustment to or disclosure in the financial statements, management should be asked to date its representation letter as of the date of the draft audit report.
- e. Inquiries to legal counsel.** A letter of audit inquiry to the Office of General Counsel and the Judge Advocate General is the auditor's primary means of corroborating information furnished by management concerning litigation, claims, and assessments. Auditors should carefully read all letters from legal counsel and ensure that all matters discussed are understood. Ambiguous and incomplete responses should be resolved with management and legal counsel and conclusions should be documented in the working papers.²²
- The request for a legal representation letter should be made as soon as possible after the end of the period subject to audit. An illustrative legal representation letter is provided in the linked document. Legal counsel should be asked to date its representation letter as of the date of the draft report. Additional inquiries may be needed if replies are not dated sufficiently close to the date of the draft audit report.²³ The General Counsel or Deputy General Counsel of the reporting entity should sign legal representation letters. The head of the finance and accounting activity preparing the financial statements should sign letters covering finance and accounting services.²⁴ Lack of either a reply, or a meaningful reply, from legal counsel should be cited as a scope limitation and should result in a qualified or disclaimed opinion.
- f. Subsequent events.** Events or transactions sometimes occur subsequent to the balance sheet date, but prior to the issuance of the financial statements and auditor's report, that have a material affect on the financial statements and therefore require adjustment or disclosure in the statements.²⁵

²⁰ See SAS No. 85, *Management Representations*.

²¹ DODIG Internal Audit Policy Memorandum Number 93- 3 (*Management and Legal Representation Letters for Audits of Financial Statements Performed Under the Chief Financial Officers Act of 1990*) states the representation letter for the principal statements of a Department should be signed by the Secretary/ Deputy Secretary of the Department and the Assistant Secretary for Financial Management. For funds managed below the departmental level, the Chief Management Official of the reporting entity will sign the representation letters along with the Chief Financial Official.

²² Auditing Interpretation No. 7 of SAS No. 12, "Assessment of a Lawyer's Evaluation of the Outcome of Litigation," discusses what constitutes an acceptable reply.

²³ SAS No. 12 "Inquiry of a Client's Lawyer concerning Litigation, Claims, and Assessments" and Financial Accounting Standards Board Statement No. 5 "Accounting for Contingencies" provide guidance on audit procedures and standards of accounting.

²⁴ See DODIG Internal Audit Policy Memorandum Number 93- 3 or current guidance.

²⁵ SAS No. 1, Section 560 provides guidance on substantive test procedures to be performed at or near the completion of the fieldwork.

- g. Related parties.** In performing an audit of financial statements, the auditor must identify related party relationships and transactions to satisfy himself/herself concerning the required financial statement accounting and disclosure.²⁶

h. Compliance with laws and regulations.

- (1) The report should indicate that any reported noncompliances were considered in preparing the auditor's opinion on the financial statements. In planning the audit, the auditor should consider the environment in which an entity operates, including government regulations. The auditor should consider government regulations in light of how they may affect the financial statement assertions.²⁷ The auditor should consider such laws or regulations from the perspective of their known relation to audit objectives derived from financial statement assertions rather than the perspective of legality per se. The auditor has a responsibility to detect and report misstatements caused by certain illegal acts, that is, those having a direct and material effect on the financial statements. Thus, the auditor should design the audit to provide reasonable assurance that financial statements are free of material misstatements resulting from violations of laws and regulations that have a direct and material effect on the determination of financial statement amounts. The report should state that management is responsible for complying with applicable provisions of laws, regulations, contracts, and grants.
- (2) Section 803(b) of the Federal Financial Management Improvement Act (FFMIA) of 1996 requires the auditor to report whether the reporting entity's financial management systems substantially comply with FFMIA section 803(a) requirements. GAO's publication entitled "[Core Financial System Requirements](#)" can aid in making this determination.

i. Internal controls.

- (1) As part of the financial statement audit, the auditor must obtain an understanding of the audited entity's internal control structure and assess audit risk and the control environment. [GAO's Standards for Internal Control in the Federal Government](#) can aid in this effort. [GAO's Federal Information Systems Controls Audit Manual \(FISCAM\)](#) can aid in reviewing computer-related controls. The auditor should form a judgement as to whether the control environment enhances internal control policies and procedures or causes them to be less effective. Audit risk can be thought of in terms of the following three component risks:
- **Inherent risk.** The susceptibility of an assertion to a material misstatement, assuming that there are no related internal control policies and procedures.

²⁶ *Financial Accounting Standards Board Statement No. 57 "Related Party Disclosures" paragraphs 2 through 4 and SAS No. 45 contain the disclosure requirements for related party relationships and transactions.*

²⁷ *The auditor's responsibility to consider laws and regulations and their effect on the audit is described in SAS No. 54, Illegal Acts by Clients.*

- **Control risk.** The risk that a material misstatement that could occur in an assertion will not be prevented, detected and corrected in a timely manner by the entity's internal controls. The internal control structure consists of (1) the control environment, (2) the accounting system, and (3) control procedures and techniques.
 - **Detection risk.** The risk that the auditor will not detect a material misstatement that exists in an assertion. Detection risk is a function of test-of-details risk and analytical procedures risk.
- (2) Based on the level of audit risk and an assessment of the entity's inherent and control risk, the Audit Director and Project Manager determine the nature, timing, and extent of substantive audit procedures necessary to achieve the resultant detection risk. The level of control risk must be assessed for all significant cycles, classes of transactions, and account balances. For those significant control policies that have been properly designed and placed in operation, the auditor shall perform sufficient tests to provide reasonable assurance of whether the controls are effective and working as designed. When control testing indicates that control policies and procedures have not been properly designed or placed in operation, or control policies are likely to be ineffective in preventing or detecting noncompliance, additional substantive testing may be required to determine whether a material misstatement has occurred. Lack of adequate controls shall be reported as findings. Paragraph [907](#) provides related reporting guidance. If the control environment causes the internal policies and procedures to be less effective, the auditor should report this condition.
- (3) Annual certification statements required by the Federal Managers' Financial Integrity Act (FMFIA) and [SECNAV Instruction 5200.35\(Series\)](#) should be reviewed to determine whether the activity has reported any material weaknesses in financial areas under audit. If the audit discloses material weaknesses that were not reported as required by FMFIA and SECNAV Instruction 5200.35(Series), the auditors should, in the report, comment on the lack of reporting as a noncompliance in the Report on Compliance with Laws and Regulations and comment on the lack of adequate internal controls in the Report on Internal Controls.
- j. **Audit Sampling.** Professional judgement must be used to determine the appropriate use of audit sampling. The ultimate use of the results must be considered in determining whether to use statistical or nonstatistical sampling. When the purpose of the sampling is to project the results, statistical sampling must be used (paragraph [606.1](#) applies). When the purpose of sampling is other than to make a projection, the choice between statistical and nonstatistical sampling is a matter of auditor judgement. Statistical sampling uses the laws of probability to measure sampling risk. Any sampling procedure that does not measure the sampling risk is a nonstatistical sampling procedure. Nonstatistical sampling may be appropriate for financial audit testing, especially during audit planning to determine the degree of compliance and related substantive testing.²⁸ Statistical sampling

²⁸ SAS No. 39, *Audit Sampling*, and the AICPA *Audit and Accounting Guide*, contain thorough descriptions of both statistical and nonstatistical sampling approaches to compliance and substantive testing.

is recommended when the measurement of risk and materiality is critical to the success of the audit. This is in line with the risk-driven approach to auditing.

For substantive testing of one or more of the five assertions embodied in financial statements, the Naval Audit Service employs statistical hypothesis testing to determine if an account balance is materially misstated. When this is done, additional risks, both Alpha risk and Beta risk, are further refinements of the basic components of audit risk, and in particular test-of-details risk. These risks are quantified to determine how much sampling is necessary to support the audit based on materiality considerations. This is consistent with AICPA Statement on Auditing Standards 47, "Audit Risk and Materiality in Conducting an Audit."

k. Reliance on the work of other audit organizations.

- (1) Within the Department of Defense, the Office of the Inspector General may delegate portions of their responsibilities for audits of financial statements to the Naval Audit Service. In most instances, the Office of the Inspector General, DOD, is responsible for rendering an overall audit opinion and issuing the required comprehensive audit report, but must rely on the Naval Audit Service to perform portions of the audit work. This work can range from limited audit work on specific financial accounts to the audit of entire subsidiary funds, such as the audit work to be performed by the Naval Audit Service on the Navy Working Capital Fund. Similarly, the Office of the Inspector General, DOD, could be requested to perform audit work for the Naval Audit Service.
- (2) The Naval Audit Service, the Office of the Assistant Inspector General for Auditing, DOD, and the General Accounting Office will cooperate fully with each other when requiring their assistance in performing audits required by the CFO legislation.²⁹ Audit work performed at the request of another audit organization will be accomplished on a timely basis and in accordance with appropriate auditing standards. Audit results will be provided to the requesting organization in a written report or memorandum.
- (3) The organization requiring assistance shall make a written request setting forth the audit objectives of the audit work to be performed, giving details of the audit work required, indicating the type of audit report required and setting forth the timeframes involved. The request should clearly describe the audit work that is required and include an audit guide when necessary. In addition, the request should provide the sampling method to be used to ensure that statistical audit results can be merged mathematically. If the objective of the audit assistance is to obtain an audit opinion, a formal report will be required.

²⁹ Office of the Inspector General, DOD, Internal Audit Policy Memorandum Number 93- 1 of 1 December 1992.

- (4) The organization performing audit assistance shall:
- (a) Provide the requesting audit organization a timely response as to their ability to comply with the objective, scope and reporting requirements. Immediately inform them of any issues that may affect their ability to complete the assignment.
 - (b) Perform the audit work requested following appropriate auditing standards.
 - (c) Provide written results to the requesting organization on a timely basis clearly describing the results of the audit work.
 - (d) Make working papers relative to the audit work performed available to the requesting audit organization when necessary to clarify issues that arise as to the results of their work.

610 -- CONCERNS FOR PROGRAM AUDITS

When all or part of an audit includes program performance, the auditor should have well developed audit objectives to effectively review and evaluate program performance. The auditor should consider the following:

- Need and appropriateness of the program.
- Clarity and consistency of program objectives.
- Program measurement criteria.
- Methods for evaluating achievement of program performance.
- Adequacy of the information system used.
- Program effectiveness.
- Cost effectiveness.
- Program cost-benefit relationship.
- Consideration of program alternatives.

Generally, at the completion of a performance audit the auditor does not express an opinion on the overall level of performance. However, the auditor should report findings and conclusions on the extent and adequacy of performance, and on specific processes, methods, and internal controls that can be made more efficient or effective.

611 – CONCERNS FOR INFORMATION TECHNOLOGY AUDITS

1. General. Naval Audit Service audits are based on compliance with government auditing standards. The field work standard pertaining to auditing computer-based systems states that when the reliability of a computer-based system is the primary objective of the audit, the auditors should perform a review of the general and application controls in the computer-based system. This evaluation should be performed using an audit program, supplemented by guidance included in the General Accounting Office's (1) [Standards for Internal Control in Federal Government](#) and (2) [Federal Information System Controls Audit Manual \(FISCAM\)](#), as needed.

- a. General controls.** These are reviewed to determine whether the controls have been designed according to management direction and known legal requirements and whether the controls are operating effectively to provide reliability of, and security over, the processed data. Audit work in this area would include reviewing organization and management controls; security controls; and system software and hardware controls.
- b. Application controls.** These are reviewed to assess their reliability in processing data in a timely, accurate, and complete manner. Audit work in this area would include reviewing conformance with applicable standards and approved design specifications and testing internal controls and the reliability of the data produced.

2. Policy. Information technology systems and issues will be selected for audit from inventories maintained by and information obtained from Department of the Navy information technology managers, including the DON Chief Information Officer (DON CIO), fleet and systems command managers, and others.

3. Audit concerns. Information technology audits can include objectives that address the following areas, depending on the nature of the audit and survey results:

- a. System requirements and effectiveness.** Systems should meet a genuine need and, once operational, should perform as intended and provide users accurate, timely, and essential information in the right form.
- b. System economy and efficiency.** Systems must acquire, protect, and use resources (such as people, property, and space) economically and efficiently.
- c. Data integrity.** Systems must have adequate controls over how data is entered, communicated, processed, stored, and reported to achieve data integrity.
- d. Safeguarding information resources.** Resources, which include equipment, software, and data, must be protected against waste, loss, fraud, theft, and unauthorized use.
- e. Compliance with laws and regulations.** Compliance with public law, Department of the Navy regulations, and other applicable regulations helps to achieve the objectives cited above. Compliance, like internal controls, should be reviewed on all audits and is normally not included as a specific objective of audits. Paragraph [819.6](#) provides related information.

4. Audit types. Specific types of information technology audits fall into at least four broad categories discussed below:

- a. Acquisition/development.** This includes new systems and operational systems undergoing change. System development audits will incorporate a life cycle management approach; the need for the system will be evaluated as well as selected critical milestone points over its life. Acquisition/ development audits normally will be narrow, focused audits timed to correct any inefficiencies prior to proceeding to the next phase in the life cycle. Specifically, audits will target system planning and initiation, requirement definition and analysis of alternatives, acquisition strategy, procurement, design, development, programming, and testing. Such audits normally will have great potential to provide significant management benefits.
- b. Operations/maintenance.** These are audits of a data service center or an audit of an operational information technology system. Such audits will focus on mission accomplishment, efficiency, effectiveness, economy, security, and controls.
- c. Incidental.** When a performance audit is being conducted and computer-processed data is an integral part of the audit, and its reliability is crucial to accomplish audit objectives, the auditors need to review the applicable computer-based systems. Unless there are other specific information technology audit objectives, auditors should review only the general and applications controls of those systems, or perform other tests and procedures to determine the reliability of the data (paragraph [412](#) applies).
- d. Consolidated systems evaluations.** Consolidated systems evaluations are performed to satisfy the requirements of the Federal Managers' Financial Integrity Act. Section 4 of the act requires each Federal agency to provide a certification of the adequacy of its accounting systems.

SPECIAL CONSIDERATIONS

612 -- LEGAL ISSUES & INQUIRIES

- 1. Legal issues.** Auditors should not attempt to pursue legal issues, interpret the intent of laws, or make recommendations involving statutory changes without first consulting with the Naval Audit Service Legal Counsel.
- 2. Investigations.** Auditors are not trained to conduct criminal investigations. This is the responsibility of the investigative or law enforcement authorities. When audit tests and procedures indicate fraud, waste, or illegal acts, the Audit Director and responsible Assistant Auditor General are to be contacted before extending audit steps. Where appropriate, the Audit Director will coordinate issues with legal counsel. Due professional care and caution must be exercised so as not to interfere with potential future investigations and/or legal proceedings (paragraph [615](#) applies).

3. Security violations. If an auditor becomes aware of a security violation, involving either the audited command or a Naval Audit Service auditor, the auditor must immediately report the circumstances to the Project Manager or, if not available, the responsible Audit Director.³⁰ In all cases, the Naval Audit Service Security Manager will be notified of any security violation involving a Naval Audit Service auditor. Normally, oral communication to the Security Manager of the audited command will satisfy the immediate reporting requirement. An audit finding describing the internal control weakness in security procedures may follow for security violations involving the audited command. If so, supervisory auditors should ensure that details provided in the audit finding do not further compromise security.

613 -- QUICK REACTION REPORTING

1. Policy and criteria. Quick reaction reporting is used for interim reporting of sensitive issues or serious problems that cannot wait for management attention in planned future audits or by the regular utilization procedures. Considerable judgement is necessary in deciding whether an issue requires immediate reporting. The responsible Assistant Auditor General **must approve** reporting under these procedures. Situations warranting quick reaction reporting *could include* but are not limited to, the following:

- a. Pending procurements not in the best interest of the Departments of Defense or Navy.
- b. Imminent waste of substantial sums of money or other resources.
- c. Instances where life or property is endangered.
- d. Significant issues that impact fleet support or readiness if the degree of urgency requires quick reaction.
- e. Situations of significant political or journalistic sensitivity. These include situations that could directly impact the private sector; seriously affect programs or functions of special interest or concern to management; and other situations that, when available to Congress or the public, could generate substantial interest.
- f. Issues of potential embarrassment to the Department of Defense or Navy. These are issues that, if included in Congressional testimony or reported by the media, would place the Department of Defense or Navy in a bad light.
- g. Serious compromises of classified information or other security violations.

2. Initial reporting.

- a. Quick reaction reports (numbered) will be issued, in the form of a letter, to the lowest command level capable of taking corrective action. Senior Department of the Navy officials will be provided reports as deemed necessary.

³⁰ *Good judgement must be used where an immediate threat to security requires the commanding officer or other appropriate official to be advised. The Project Manager should communicate to all assigned staff the procedures to be followed in such circumstances. Such communication should take place during the initial auditor assignment process.*

- b. The responsible Assistant Auditor General must take those actions needed to effect a suspension of the action being questioned until the auditors' position has been fully evaluated and an official position is taken. In extremely urgent situations, reporting should be accomplished face-to-face or by telephone. Time permitting, a letter will be provided that states the problem briefly; explains its urgency; provides any essential background information needed to fully understand the problem and its significance and/or sensitivity; provides recommendations to correct the problem, and requests management comments. In urgent situations, the letter will be issued confirming the previously provided oral advice. Normally, a maximum comment period of 15 days from the date of the report will be allowed. Management comments should be incorporated into a final report. If sufficient audit work has been performed and comments are not received within 15 days, the report should be issued as a final report.
- c. If additional information provided by management convinces the auditors that a significant and/or time sensitive condition did not actually exist, no additional reporting is required. In such instances, a complete record of information considered by the auditors in making this decision will be retained in the auditors' working papers. The responsible Assistant Auditor General will issue a letter to all concerned stating that the problem has been resolved and explaining how.
- d. Normally, the circumstances pertaining to a quick reaction report will also be reported in a subsequent audit report. Recommendations other than those in the quick reaction report normally will be needed to correct procedural weaknesses that led to the problem. In such cases, the problem reported in the quick reaction report should be used as an example in a finding that discusses the need to correct procedural weaknesses. If the quick reaction report were formalized and appropriate action taken, it would not be appropriate to repeat the recommendations made in the quick reaction report in a subsequent report. The final audit report should discuss the circumstances pertaining to the quick reaction report, the actions recommended, and the actions that were taken by the command/program manager as a result of the quick reaction report. The formal audit report on a quick reaction item will be issued when all circumstances supporting the finding are known and the command/manager has been allowed a reasonable period to provide comments, generally up to 15 calendar days.

614 -- HOTLINE PROGRAMS

1. General. The Department of Defense and Navy Hotline Programs are mechanisms to ensure that allegations of fraud and mismanagement are examined. All substantive allegations received through the hotline programs normally are examined within the traditional chain of command structure. When feasible and appropriate, Department of the Navy commands request auditors, inspectors, and/or investigators to assist in examining allegations.

2. Policy. The AAG that receives a request to examine a hotline allegation will decide whether to approve the request. The AAG will notify the requestor of the decision to accept or decline the request within 5 workdays of receipt of a written request. Requests for audit assistance should be made in writing. This will ensure that the audit objectives are consistent with the intent of the allegation. Preliminary discussion with the requestor is encouraged. Only hotline allegations

involving waste or mismanagement should be accepted for review. If the request involves fraud or illegal acts, advise the command to request assistance from the Naval Criminal Investigative Service. Investigative assists, including reviews of hotline allegations, will not result in an audit report. The results of the review will be provided to the requesting official.

3. Gratuitous information involving fraud or mismanagement. Occasionally, auditors receive fraud and mismanagement allegations unrelated to planned or ongoing audits. When approached in person or by telephone with such allegations, auditors should be polite, attentive, and helpful. While the exact sequence varies from case to case, auditors should:

- a. Determine whether the individual has notified the appropriate command of the allegation. If not, encourage this as the first step for obtaining corrective action.
- b. Advise the individual that a hotline number may be called in addition to, or in lieu of, advising the command. If deemed appropriate, provide the hotline numbers. The numbers are:

Navy

800-522-3451

DOD

800-424-9098 (Toll free)

Navy personnel should call the Navy hotline number but Marine Corps personnel should call the DOD hotline number.

- c. Advise the individual that the identity of hotline callers is kept confidential, if desired, and that all allegations are investigated.
- d. Advise the individual of the option to call the hotline number even if the allegation is considered appropriate for audit.
- e. If the allegation involves other than a command, activity, or function undergoing audit, and the individual indicates an unwillingness to advise the management or call a hotline number, provide details to the responsible Assistant Auditor General for disposition.
- f. Review allegations received by mail if they involve a command, activity, or function undergoing audit and are clearly audit matters. Otherwise, forward them to the responsible Assistant Auditor General for disposition.

615 -- FRAUD

1. Policy and procedures concerning suspected fraud or other criminal practices.

- a. If auditors suspect fraud or other criminal practices ([subparagraph 6](#) provides fraud characteristics and indicators), they should discuss the circumstances with their immediate supervisor. The Project Manager will report the circumstances to the responsible Audit Director and Assistant Auditor General. Where appropriate, the Audit Director will then report the circumstances to the Naval Audit Service Legal Counsel.

- b. After these discussions, a decision may be made to do additional work. In this case, the Project Manager should extend audit steps, in accordance with direction received from the Audit Director and/or Assistant Auditor General, to obtain sufficient evidence to determine whether *potential* fraud or other illegal acts have occurred. Auditors should use caution not to extend audit steps beyond the scope of the audit or to jeopardize potential investigations by legal authorities.
- c. When the extended audit steps and procedures confirm that fraud or other criminal acts **may have occurred**, the Audit Director will advise the Assistant Auditor General for Infrastructure Audits. The Fraud Monitor, who is assigned to the Assistant Auditor General for Infrastructure Audits, is responsible for coordinating all potential fraud issues with the Naval Criminal Investigative Service.³¹ Following coordination with counsel, the Fraud Monitor will provide guidance and/or approval for oral discussion with the audited commanding officer or program manager and the Naval Criminal Investigative Service. The immediate superior in command will be advised when the commanding officer or program manager under audit is potentially involved in the suspected violation.
- d. Where appropriate and after approval by the Fraud Monitor, a written confirmation of the oral discussions with the Naval Criminal Investigative Service will be prepared and addressed to the Director, Naval Criminal Investigative Service. A sample "Advisory Report Concerning Suspected Violation of Federal Statutes" is provided in the linked document. The Assistant Auditor General for Infrastructure Audits will advise if a pre-release review of the advisory report is required by the Fraud Monitor. Information copies of the advisory report will be provided to the Fraud Monitor and the Commanding officer or program manager under audit, unless such official is a potential subject in the advisory. In such cases, the information copy will be provided to the immediate superior in command. The advisory report satisfies the separate report of fraud or other criminal acts required by government auditing standards.
 - (1) The advisory report will **not** enclose any draft audit findings. The report will discuss only the details of the suspected criminal activity.
 - (2) To avoid compromising data that might be used in a legal action against an individual, the advisory report should not cite names of individuals or private entities involved or otherwise disclose their identity. Questions on content should be discussed with the Naval Audit Service Legal Counsel.
 - (3) The responsible Assistant Auditor General will have the advisory report hand-delivered or mailed in a double envelope, that is marked "**TO BE OPENED BY THE DIRECTOR**", to the Naval Criminal Investigative Service office that is designated by the Fraud Monitor. The advisory report will not be delayed pending preparation of a draft audit finding.

³¹ This includes all potential fraud issues identified during audit or requests for assistance from the Naval Criminal Investigative Service.

- (4) The Naval Criminal Investigative Service will be requested to report the results of actions taken based on the advisory report to the responsible AAG. The AAG will advise the Fraud Monitor of the results of the investigative efforts.
- e. If an investigation is called for based on disclosure of a possible fraudulent practice, it is management's responsibility to initiate such an investigation under the provisions of [Secretary of the Navy Instruction 5520.3 \(Series\)](#).

2. Investigative Assistance.

- a. Requests for investigative assistance should be directed to the Assistant Auditor General for Infrastructure Audits for approval. Local communications among auditors and investigators on the merits of a potential investigation effort are acceptable. Audit support of criminal investigations is authorized and encouraged to the greatest extent possible within legal limitations and availability of resources. AAGs are strongly encouraged to have their auditors work with criminal investigation organizations to exchange information on situations discovered during audits where, although no fraud may be suspected, weaknesses in controls and procedures could lead to incidents of fraud.
- b. An auditor assigned to perform investigative assistance is usually requested by the investigative organization to provide written correspondence summarizing results of the assist work. Depending on the circumstances, such summaries can be in the form of narrative working papers, letters, or memoranda from the assisting auditor (rather than from the Naval Audit Service) to the requesting investigative official (such as the head investigator on the case). Regardless of the form of communication used, investigative assistance is not considered an audit. Information provided must **not** be on Naval Audit Service letterhead stationery of any type and should **not** be provided in a format that would appear to be an audit report.
- c. Investigative organizations consider our people expert auditors. Thus, they normally do not challenge or confirm the accuracy of results provided. Investigators normally accept the results as professionally based, accurate information and rely heavily on it in deciding whether to pursue prosecution. Therefore, although auditors performing investigative assistance are under the operational control of the requesting investigative organization, Naval Audit Service management must ensure that the assist work performed meets professional standards. Only auditors who have demonstrated the capability to independently perform professional work should be assigned to do investigative assistance. Unless it is impracticable, an Audit Director will review the work while it is in process and when it is completed. Supervisory Review Comments sheets will be prepared as described in paragraph [510](#) but they will not be forwarded to the investigative organization.
- d. Auditors will testify when requested in conjunction with investigative assists.
- e. All papers prepared on investigative assists will be turned over to, and maintained by, the requesting investigative organization.

- f. To close out an investigative assist effort, provide a memorandum marked "For Official Use Only" (FOUO) and written in audit terms, not investigator terms, to the Assistant Auditor General for Infrastructure Audits detailing the information below.³² When preparing the memorandum, do not compromise the information provided to the client. The client should be asked to review the memorandum before sending it to the Assistant Auditor General for Infrastructure Audits. The memorandum should state the:

- (1) Subject of the request, objectives, and job number.
- (2) Scope and methodology of the work.
- (3) Nature of the product provided to the investigative organization. Do not identify individuals by name, social security number, or other personal identifiers. Do not discuss conclusions nor provide details that could jeopardize the investigation.
- (4) Potential audit areas for future consideration arising from the assist.

3. Audit findings related to suspected fraud or other criminal acts.

- a. Unlike the Advisory Report Concerning Suspected Violation of Federal Statutes, draft findings will **not** refer to criminal statutes or to the possible occurrence of any crime or existence of any criminal intent. Further, draft findings will **not** include the names of any individuals or contractors.
- b. Draft findings will address noncriminal aspects of fraud or other criminal activities, such as mismanagement and improper practices. For example, auditors may suspect theft or discover that government property is missing at an audited activity. While the draft finding should discuss any inventory control and other management problems related to the missing property, it cannot indicate that the auditor suspects or has discovered theft or any other criminal practices. Findings may discuss the increased potential for fraud or other criminal practices that may result from inadequate or nonexistent internal controls.
- c. To ensure that reporting will not compromise an investigative effort or potential legal proceedings, the audit office should provide the draft finding to the Naval Audit Service Legal Counsel before submission to the appropriate auditee levels.

4. Distribution of reports of suspected fraud or other criminal practices. The distribution of reports of suspected fraud or other criminal practices is delineated in Section 7 of the linked document [“Report/Announcement Letter Distribution and Coordination”](#).

5. Improper practices not involving fraud or other criminal activity. Advisory reports will **not** be issued for matters concerning suspected violation of Federal statutes. Although noncriminal statutes may be cited in an audit finding, if necessary, every effort should be made to cite Department of the Navy or Department of Defense directives instead. Audit findings must, however, cite Title 31, U. S. Code, Section 1301(a) (formerly 3678 Revised Statutes) and

³² For additional information concerning the format to be used in the memorandum, the Assistant Auditor General for Infrastructure Audits should be consulted.

Title 31, U. S. Code, Section 1517 (formerly Section 3679), whenever appropriate. A finding that discloses a potential Antideficiency Act violation should make a recommendation to the Assistant Secretary of the Navy for Financial Management and Comptroller (ASN (FM&C)) requesting an investigation of the potential violation. Normal audit utilization procedures will otherwise be followed for findings concerning improper practices.

6. Fraud characteristics and indicators. Fraud encompasses an array of illegal acts and irregularities and is characterized by intentional deception or manipulation with adverse affects. Fraud can be perpetrated for the benefit of or to the detriment of an organization, agency, or activity, and can be carried out by a person or persons outside as well as inside the organization, agency, or activity.

a. Definition. "Fraud" is taking or attempting to take unfair advantage of the Government by willful actions. Some examples are:

- Offering, paying, or accepting bribes.
- Offering, giving, or accepting gratuities contrary to governing standards of conduct.
- Making false statements.
- Submitting false claims.
- Using false weights or measures.
- Evading or corrupting inspectors and other officials.
- Using deceit either by suppression of the truth or misrepresentation of a material fact.
- Adulterating or substituting materials.
- Falsifying records and books of account.
- Arranging for secret profits, kickbacks, or commissions.
- Conspiring to use any of these devices.

Fraud also includes those cases of conflict of interest, criminal irregularities, and unauthorized disclosure of official information that is connected with procurement and disposal matters.

b. Other criminal or improper practices. Some violations of law or regulations, such as violations of Department of the Defense Standards of Conduct ([DOD Regulation 5500.7-R "Joint Ethics Regulation"](#)) and Antideficiency Act Violations, may or may not be criminal practices. Violations of the Standards of Conduct governing the conduct of Naval personnel are improper, but are not criminal practices. Violations of the same instruction concerning, for example, improper affiliations and financial interests; misusing

inside information; misusing Government position; improperly dealing with present and former military and civilian personnel; improper commercial soliciting; and improper assignment of Reserve personnel, may or may not be criminal, depending on the circumstances. Violations of Title 31, U. S. Code, Section 1301(a) (formerly Section 3678) are improper but not criminal. In these instances, auditors should contact the Naval Audit Service Legal Counsel for guidance.

c. Fraud indicators. The key to prevention and detection of fraud and illegal acts is recognition of conditions that allow these practices to go undetected. The American Institute of Certified Public Accountants developed the following warning signals to assist auditors in identifying the possible existence of fraud:

- (1) Difficulty in obtaining audit evidence for unusual or unexplained entries, incomplete or missing documentation and authorizations, and alteration of documentation or accounts.
- (2) Inadequate controls over cash accounts or credit cards.
- (3) Unexplained fluctuations in material account balances, physical inventory variances, and inventory turnover rates.
- (4) Problems encountered in performing an examination, such as delay situations or evasive or unreasonable responses to audit inquiries.
- (5) Widely dispersed locations accompanied by highly decentralized management and inadequate reporting systems.
- (6) Known continuing weaknesses in internal controls over access to computer equipment or electronic data entry devices.

PART II -- AUDIT UTILIZATION

616 -- PURPOSE

Audit "utilization" is continuous communications between auditors and managers during an audit in an effort to obtain management agreement and put audit results to use as soon as they become known. Management should be given an opportunity to respond to and correct adverse conditions during the audit. **Efforts to obtain management agreement should begin well before the draft report is issued.** Any known corrective actions taken should be described in the audit report. If appropriate, a statement that action is completed and no additional action is needed will also be included in the report below the recommendation. **When management action is completed on a recommendation during the audit, the recommendation will still be included in the report.** This allows the Naval Audit Service and the Naval Inspector General (the owner of the audit followup system) to comply with external reporting requirements and to track all corrective actions in the audit followup system. Credit will also be given for planned

actions that will materially improve operations that were initiated independent of the audit recommendations. **While early and continuous efforts to obtain management agreement are critically important, they should not be allowed to unduly delay reporting of audit results in final reports.**

617 -- OVERVIEW

1. Discussions. During the verification phase of the audit, the Project Manager should informally discuss and submit findings, recommendations, potential monetary benefits, and internal control weaknesses to the audited activity/program manager as they are developed.³³ These items can also be discussed with and submitted to managers at other command levels or activities that can take action or would have an interest in the recommended corrective actions. Discussions with these managers and informal responses should be adequately documented in the working papers.

2. Draft report. Draft reports are provided to ensure that audit results are accurately, fairly, and impartially presented, and to seek management agreement on specific and realistic recommendations, completion dates, potential monetary benefits, and material internal control weaknesses. The [“Editors Checklist—Draft Reports”](#) is an optional tool that can be used at this stage of an audit.

- a. After “selective” referencing is completed (paragraph [511](#) applies), an edited draft report, signed either by the Audit Director or Assistant Auditor General (AAG), will be provided electronically to each recommendation addressee requesting that written responses be prepared. Exceptions to the electronic report distribution rule include classified reports and other reports containing sensitive information. The draft report will be submitted to the auditee prior to the exit conference, with information copies provided simultaneously to two echelons above the auditee(s) but no higher than the Assistant Secretary of the Navy (ASN) level. The transmittal letter will identify where comments are to be sent.
- b. The AAGs will inform the Auditor General of any issues addressed to the Chief of Naval Operations or the Commandant of the Marine Corps and above.

3. Exit conference. An exit (closing) conference will be held following a reasonable period of time for management to develop a position on the draft finding(s), recommendation(s), potential monetary benefit(s), and material internal control weaknesses. The purpose of this conference is to ensure a full understanding of the audit and management positions, to resolve questions of fact or misunderstandings, and to ensure that management is aware of the report publication and resolution process. Paragraph [622](#) provides related information.

³³ *If recommendations are to be made to non-Navy activities, discussions should be held with DODIG prior to submitting the report for utilization.*

618 -- PROCEDURES

1. Presenting and discussing individual draft findings and recommendations.

- a. **Preliminary submissions.** As a general rule, Project Managers should informally present draft findings, recommendations, potential monetary benefits, and/or material internal control weaknesses to, or discuss them with, management officials to whom they are to be directed prior to officially submitting them in writing for a command signature position. The Project Manager must review and approve informal/formal draft findings, recommendations, and potential monetary benefits *before* they are utilized with the audited command/program manager or directed to other activities/program managers. **An optional “initial audit assessment” approach can also be used.**
- b. **Purpose of preliminary presentations and discussions.** The objectives of preliminary presentations or discussions, as an audit progresses, are to: verify supporting facts; obtain additional facts or relevant background information; gain agreement on criteria used (such as laws, regulations, and instructions); gain agreement on auditor conclusions, recommendations, potential monetary benefits, and material internal control weaknesses; expedite completion of the audit; and ensure that draft audit findings and reports accurately, fairly, and impartially portray the condition(s) disclosed and management’s unofficial position. An additional purpose of these discussions is to determine whether the report should be classified. **It’s particularly important that classification discussions occur during the audit in order to avoid unnecessary delays in report publication.** Classification discussions apply to those instances where data is extracted from classified documents or where reports are constructed from unclassified documents but present the type of information that might otherwise be classified. In both instances, the auditor should discuss the information with the owner(s)/keeper(s) of the information and determine if the specific information extracted/aggregated is classified. The results of these discussions and determinations should be documented and initialed (agreed to) by the owner(s)/keeper(s) of the information. This documentation should be included in the working papers. If necessary, report classification should also be discussed with senior management prior to issuing the draft report, with management’s opinion documented and included in the working papers.
- c. **Request for comments.** Written comments below the command/program level should be sought to confirm oral discussions. Sometimes, managers express agreement with a finding/recommendation explained to them orally, but later disagree when they see it in writing. Informally providing appropriate managers’ advance written copies of findings helps identify and solve these communication problems.
- d. **Inability to obtain responses.** Copies of summaries of discussions of draft findings, including management’s reaction/opinion of the finding content and/or recommendations, will be provided to the audited command(s)/program manager(s) when written responses cannot be obtained.
- e. **Copies to other cognizant managers.** Draft findings and recommendations may also be informally provided during the audit to other cognizant management officials. Such findings may be discussed in face-to-face meetings with those activities/program

managers to the extent practicable. Where geographic location and travel fund limitations preclude a face-to-face meeting, auditors may discuss the findings and recommendations by telephone or other electronic means, or request discussion assistance from other Naval Audit Service auditors at or near those locations.

- f. Drafts to major commands and Defense Agencies.** The AAG must be informed of draft findings with recommendations addressed to Echelon II commands and above or to activities/program managers outside the Department of the Navy. AAG approval is required prior to release. Recommendations to defense agencies should be coordinated through the Office of the Assistant Inspector General for Auditing, DOD (paragraph [803](#) provides related guidance) (the correct address can be found in the document entitled [“Report/Announcement Letter Distribution and Coordination”](#)). Either the Audit Director or AAG must sign these findings out.
- g. Debriefing management.** Audited management should be debriefed when any audit work at their activity is completed. The debrief must cover the audit objectives, scope, methodology, and audit results (potential system-wide, local, and nonmaterial). At a minimum, a narrative summary of the debrief results should be included in the working papers.
- h. Nonmaterial findings.** Nonmaterial findings should be provided to the activity/program manager for written comments during the verification phase and they should be discussed at the debrief. If nonmaterial findings were not previously provided to management, they should be provided at the debrief with a copy retained in the working papers. Written responses should be requested from management and retained in the working papers. A disagreement on a nonmaterial finding received subsequent to exiting the activity will be brought to the AAG’s attention and a decision will be made as to whether formal reporting as an undecided issue is warranted. Documentation on such findings will be retained in the working papers.

2. Release to persons other than cognizant managers. Preliminary submissions (e.g., briefing charts), draft findings, and draft reports are pre-decisional material internal to the Department of the Navy and, as such, are not releasable outside Department of the Navy except on specific approval by the Director, Policy and Oversight Division. At the time the draft findings or draft report is approved for release, the Auditor General and action addressees will also be advised. Draft findings and reports must also be marked, "Releasable outside the Department of the Navy only on approval of the Auditor General of the Navy." In addition, the transmittal letter to the requestor will indicate this information is preliminary and subject to change based on Navy management’s response and our analysis of their comments.

3. Draft report.

- a.** The Project Manager will forward the draft report electronically with an official cover memo, to the Audit Director, AAG, and editor simultaneously.
- b.** Prior to the exit/closing conference, a draft report will be issued electronically by the editors to all recommendation addressees for comment. Exceptions to the electronic distribution rule include classified reports and other reports containing sensitive

information. AAG approval is required to address or distribute draft reports. Simultaneous information copies of draft reports will be provided electronically to two levels above each recommendation addressee but no higher than the Assistant Secretary of the Navy level.

- c. The draft report will be edited and “selectively” referenced before the Audit Director or AAG signs it. Nonmaterial findings that management has previously agreed with, in writing, should just be discussed in the Executive Summary portion of the draft report. Nonmaterial findings where audited managers have not provided a response that specifies agreement to correct the problem(s), should be included in the draft report as findings.
- d. The draft report should be more than an assemblage of findings. It should be an integrated report, and should be as close to the final report as practicable. Specifically, it should contain a Table of Contents and the various report sections specified in [Chapter 8](#) or [9](#), with each section completed to the extent possible. The report should also contain any written comments previously received.
- e. The transmittal letter for the report will be addressed to all recommendation addressees. The letter should request management provide (1) a draft response by e-mail for discussion/negotiation purposes and (2) the official comments generally within 30 calendar days. Management should be requested to e-mail the official responses. The transmittal letter should:
 - (1) Clearly indicate which findings, recommendations, and potential monetary benefits each addressee should respond to.
 - (2) Advise when an addressee has already responded in writing to one or more of the findings.
 - (3) State that previous responses may be modified, if desired.
 - (4) Allow each recommendation addressee to comment on auditor-identified material internal control deficiencies or other findings and recommendations in the report, if desired.
 - (5) Request that management review reports that contain “For Official Use Only” (FOUO) information, if applicable, and identify any portions of the report that need to be protectively marked. Comments on the need for protective markings have been most frequently needed when the audit has included business-sensitive information. Such information would include, but not be limited to, overhead costs and rates, direct and indirect labor rates, actual cost data for the labor and material, variances of actual costs to budgeted amounts, overtime-related data, and billing and actual variances (gains/losses).
 - (6) If deemed necessary by the responsible AAG, request that management provide, in writing within 30 calendar days, a security classification of the report when information used in the report is extracted from classified documents. The AAG

should review the results of earlier discussions and related working paper documentation (paragraph [618.1b](#) applies) before making this decision.

- (7) If deemed necessary by the responsible AAG, reports should be tentatively classified if they are constructed from unclassified documents but present the type of information that might otherwise be classified. Reports could include classified material because of the effect of combining unclassified information from different sources. We have had several instances where this has happened. The transmittal letter should request a classification review from personnel responsible for the program and be marked with the tentative classification preceded by the word "tentative". The transmittal letter should also indicate why the report is tentatively classified. The AAG should review the results of earlier discussions and related working paper documentation (paragraph [618.1b](#) applies) before deciding whether a report should be tentatively classified.
- (8) If any closing conference arrangements have been made, they should be referenced in the letter.
- f. If the response is not received at the end of the requested response date, the AAG, through consultation with the Audit Director and/or Project Manager, will determine the reason for the delay and grant an extension, in writing, if warranted. Extensions should not be granted routinely if a reasonable period of time was initially provided. If responses are not received by the requested response date (or extended deadline), the final audit report is to be published. The Auditor General is to be advised of the planned publication. The findings are to be shown as undecided on the basis that comments were not provided promptly enough to allow adherence to the standard for timely audit reporting.

4. Draft reports with recommendations to Defense Agencies. In accordance with an Office of the Assistant Inspector General for Policy and Oversight, DOD (OAIG-P&O) Statement of Policy, the Office of the Inspector General for Auditing, DOD (OAIG-AUD), will staff all reports of audit to Defense Agencies. For all draft audit reports, where recommendations are made to Defense Agencies:

- a. The report should be written with recommendations addressed to the Director (Defense Agency).
- b. Ten copies of reports addressed to DFAS, and two copies of reports addressed to other Defense agencies, will be transmitted to the OAIG-AUD AFTS Directorate via separate cover letter. The OAIG-AUD will review the recommendations and forward the report to the Defense Agency for action. If the report contains recommendations directed to both the Department of the Navy and a Defense Agency, the report will not be forwarded to the OAIG-AUD in its entirety. Only Section A and those findings with recommendations to a Defense Agency will be forwarded.
- c. The transmittal memo to OAIG-AUD should contain the following statement:

"This report (or finding(s), as applicable) includes recommendations to (Defense Agency). We are providing this report (or finding(s)) for your review in accordance with policy issued by the Assistant Inspector General for Policy and Oversight, DOD on 27 November 199X.³⁴ After your review, please forward the report (or finding(s)) to (Defense Agency) and inform us of your action. Should you have questions or require additional information, please contact (name of Project Manager) at (xxx) xxx-xxxx. This report (or finding(s)) contains pre-decisional material internal to the Navy. As such, the report (or finding(s)) is not releasable to anyone outside of your office other than the (Defense Agency)."

- d. A copy of the draft report addressed to DFAS should also be provided to the DODIG field office in Cleveland.
- e. When a draft finding contains recommendations to both the Department of the Navy and a Defense Agency, the Director, Policy and Oversight Division should be contacted for advice on what to transmit. These types of situations will be handled on a case-by-case basis.

5. Followup on draft report. After the draft report is issued, the Project Manager should follow up on the draft report by visiting and/or calling each recommendation addressee to: ensure they have received the report, inquire about the status of responses, attempt to resolve any issues/questions that arise, and schedule a closing conference. The extent of such followup necessary for each audit depends on how many problems exist. For example, if one telephone call provides positive assurance that responses will be timely and a closing conference is scheduled, or not necessary, further followup may be unnecessary. **The Project Manager should obtain an advance copy of management's draft comments whenever possible and suggest appropriate changes that will help resolve outstanding issues.**

6. Closing conference.

- a. With rare exception, a closing (exit) conference will be held following a reasonable period of time for management to develop a position on the draft findings, recommendations, potential monetary benefits, and material internal control weaknesses identified. An exit conference *should* be held with each recommendation addressee. If the audit produces no material findings, a conference should still be held with the audited commands/ program managers to close out the audit. To the extent practicable, closing conferences will be face-to-face meetings. However, travel costs must be considered and professional judgment used. Since recommendation addressees may be geographically dispersed, especially for performance audits, the Project Manager and Audit Director may take advantage of auditors at audit sites in San Diego and Norfolk to assist in conducting necessary closing conferences. Another option for some cases, dependent on the significance and sensitivity of issues involved, is to conduct closing conferences via telephone (by conference calls or by regular telephone calls) or Video Teleconference (VTC). The only time a closing conference will not be held is when management of the audited activity specifically waives the conference. In those cases, the working papers will contain a memorandum stating the reasons, as best as the auditor can determine, as to

³⁴ Cite 27 November 1992 for recommendations to the Defense Finance and Accounting Service. Cite 27 November 1991 for recommendations to all other Defense Agencies.

why the audited activity elected not to have an exit conference.

The goals for a closing conference are to:

- (1) Ensure a full understanding of the audit and management positions on the facts, conclusions, and opinions -- inclusive of the auditor's opinion on material internal control deficiencies, audit recommendations, and potential monetary benefits.
- (2) Resolve questions or misunderstandings.
- (3) Ensure management is aware of the report publication and resolution process.

Management should be advised that their verbatim comments will be included in the final report. If management's comments are not received by the requested date, the report will be issued indicating that such findings are undecided. Responses received subsequent to publication of the report will be handled in the post-publication/ resolution process.

- b. At a minimum, exit conferences will be attended by the Project Manager, the Audit Director, and *appropriate* senior level official(s) from the audited activity. Appropriate senior-level officials are normally the individuals responsible for overall management, direction, and control of the activity, function, program, or area audited. Project Managers and Audit Directors should recommend which senior officials should attend. The following guidance is provided for determining the senior officials:

- (1) *Single location audits, nonappropriated fund audits, Commercial Activity reviews, and unannounced disbursing audits*: the commanding officer or equivalent.
- (2) *Request audits*: the official who requested the audit and/or a senior official representing the auditee/recommendation addressee.
- (3) *Performance audits*: the project manager/activity commander and a person at least one level above him or her.
- (4) *Audits at Headquarters activities*: the flag officer with overall responsibility for the function audited.
- (5) *Audits performed at more than one location*: the senior officer(s) with overall responsibility for the functional area or system audited.

619-- UNDECIDED ISSUES

Throughout the utilization process, Audit Directors and Project Managers must exercise "due professional care" in making sure that the audit position for an "Undecided" issue is reasonable, accurate, and supported by audit working papers. If working papers do not support the audit position, the responsible Assistant Auditor General will direct/approve additional audit work or the deletion of the finding or recommendation from the draft report. A decision to delete a finding or recommendation must be documented in the audit working papers. When appropriate, audit reports will be published with "Undecided" issues. Actions on published audits with "Undecided" issues involve many levels of Navy management and are principally monitored by the appropriate AAG. The responsible AAG, or his designated representative, will participate in

post-publication resolution and followup actions.

620 -- COMMERCIAL ACTIVITY REVIEWS

Commercial Activity reviews do not result in traditional findings, recommendations, or reports to utilize with management. However, auditors must still keep management informed of the progress and conditions found during Commercial Activity reviews so timely action can be taken to correct any deficiencies noted and resolve any disagreements.

621—ADMINISTRATION ACTIONS

The audit verification phase is considered complete on the date the draft report is issued to management. The following administrative actions should be completed, to the maximum extent possible, prior to the completion of the verification phase:

- Final supervisory reviews for assigned staff must be documented (paragraph [510](#) applies). Acceptance of the working papers by the Project Manager affirms that all working papers prepared by the subordinate staff have been reviewed, all review comments have been completely responded to and are documented in the working papers, all cross referencing has been completed and found satisfactory, and draft finding(s) have been reviewed and acted on (declined or accepted for further processing to the audited command/program manager) by the Project Manager.
- All official files and correspondence obtained from management must be returned and, when appropriate, charge-out documents to the auditor(s) cancelled.

622--ACTIONS RELATING TO REPORT PUBLICATION

The Project Manager/Audit Director should continue to take a proactive approach in following up with recommendation addressees in an attempt to resolve all issues after the draft report is issued but prior to report publication. This should include requesting an advance copy of proposed management comments and suggesting changes to those comments that would lead to resolution (paragraph [838](#) provides related guidance). An audit position may be modified on the basis of substantiated management comments whether verbal or written. Management's official comments will be presented in their entirety and verbatim in the report as an appendix including letterhead and signature block unless prohibited for privacy or security reasons. The auditor's basis for disagreement with management's position will be included in the report. The audit report will be published without comments after a reasonable period, to be established by the responsible Assistant Auditor General based on the circumstances of each audit. **Non-receipt of responses, or failure to comment on potential monetary benefits, will be reported as "Undecided" issues (paragraph [839.6](#) provides related guidance).**

After report publication, an optional [Post Audit Survey](#) can be used to assess customer satisfaction.

CHAPTER 7

AUDIT FOLLOWUP

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701—OVERVIEW OF AUDIT FOLLOWUP

1. [Secretary of the Navy Instruction 5200.34 \(Series\) \(Management of Audit Decision and Followup Functions\)](#) is the basic directive governing followup in the Department of the Navy (DON). It essentially requires the following:

- a. Where there is concurrence with the facts, conclusions, and recommendations in an audit report, corrective action will be promptly initiated and followed to completion by management.
- b. Where there is disagreement with the facts, conclusions, recommendations, or potential monetary benefits in an audit report, the matter will be referred through the chain of command until resolved. Resolution must be reached within 6 months of the final report publication date.

2. The Naval Inspector General is the Navy's central focal point for followup. Responsibilities in this capacity include, among others, monitoring compliance with followup program requirements, summarizing information received from Navy components, and submitting semiannual Navy followup status reports to DOD Inspector General, through the Under Secretary of the Navy.

3. In addition to the central focal point, other focal points are established at Echelons 2 and 3 commands throughout the Department of the Navy. Their responsibilities include, among others, ensuring that: concurred-in recommendations are acted on timely; prompt action is taken toward resolution of undecided issues; and semiannual followup status reports are submitted.

4. The Naval Audit Service conducts selective followup audits to ensure that corrective actions have been taken and that benefits have been achieved to the maximum extent possible.

702 -- AUDIT RESOLUTION STANDARD

1. The Comptroller General's [*Standard for Internal Control in the Federal Government*](#) established an audit resolution standard that requires managers to take prompt, responsive action on all audit findings and recommendations.
2. The audit resolution process begins when the audit results are reported to management, and is completed only after action has been taken that corrects identified deficiencies, produces reasonable improvements, or demonstrates that the audit findings and recommendations are either invalid or do not warrant management action.
3. The standard states that auditors are responsible for selectively following up on audit findings and recommendations to ascertain that resolution has been achieved.

703 -- FOLLOWUP POLICY

To comply with [*Secretary of the Navy Instruction 5200.34 \(Series\)*](#) and the audit resolution standard, Audit Service staff will follow up on findings and recommendations from the most recent Naval Audit Service audit and more current audits performed by the General Accounting Office, Department of Defense Inspector General, or other audit organizations. The purpose is to ascertain whether resolution has been achieved.

1. During all audits, auditors must, as a minimum, follow up on all findings, recommendations, and previously reported potential monetary benefits within the objectives and scope of the current audit.
2. During followup, the auditor must determine whether the command's action on the findings, recommendations, and potential monetary benefits meets one of the following conditions:
 - a. Corrects the identified deficiencies.
 - b. Produces reasonable improvements (where audit findings identify opportunities for improvement) and achieves agreed-to/reasonable savings.
 - c. Demonstrates that the audit findings and recommendations were either invalid or no longer warrant management action.
3. Determining whether command action meets one of these conditions may prove quite simple or quite complex (that is, substantial audit testing may be required) depending on the nature of the recommendation. For example, following up on a recommendation that a command recover improperly used funds may simply entail verifying that the funds have been recovered and accounted for by the command. However, other audits may disclose widespread weaknesses in a major program. They may include recommendations for significant changes, and may require a large investment of audit resources to properly determine whether a command's corrective actions are adequate. If such is the case, detailed followup should not be performed as part of the ongoing audit, but rather a separate followup audit would be appropriate. The Audit

Director/Project Manager should recommend to the Assistant Auditor General (AAG) that a followup audit be scheduled. Paragraph [705](#) discusses followup audits.

704 -- FOLLOWUP STATUS REPORTING

1. The Audit Tracking System, maintained by the Strategic Sourcing and Resources Management (SR) Directorate, is capable of tracking the status of all findings and recommendations (inclusive of potential monetary benefits) from issuance of the audit report through implementation of corrective action for followup purposes. The system also shows the command(s) responsible for action and the action due date(s). The Audit Tracking System supports semiannual reporting requirements to Congress and assists in planning followup audits. In this system, as well as throughout the entire followup reporting process, each recommendation is classified in a category as follows:

O - Open based on published report. Action on concurred-in or resolved recommendation has not been completed. This includes situations where management agreed that potential benefits exist but the specific amounts have not yet been determined.

OA - Open suspense; command response sent to the responsible auditors for review.

OP - Open; based on correspondence received after publication indicating action is pending.

C - Closed based on published report; or closed after publication with all recommended action complete, including agreement on potential monetary benefits.

CA - Closed with alternative action taken.

CI - Closed without action; recommendation no longer valid.

CN - Closed without implementation despite the use of all feasible strategies.

U - Undecided based on published report; no agreement between auditors and management has been reached on procedural recommendation(s) and/or potential monetary benefits

UA - Undecided; action pending from NAVAUDSVC.

UP - Undecided; action pending from focal point.

XO - Canceled.

2. AAGs provide the initial input for the Audit Tracking System (i.e., categories O, C, and U) in the form of Section C of each final audit report. Paragraph [839](#) provides detailed guidance for completing Section C of the audit report.

3. The Naval Audit Service maintains the Audit Followup Status Reporting System for the Naval Inspector General. Navy activities and the Commandant of the Marine Corps are responsible for providing the input for this system to the responsible AAG and to the

SR Directorate. Activities must be informed of this requirement and their responsibilities during opening and closing conferences and in the audit report transmittal letter. The system input must be provided by management within 30 days after either the final report publication date, or the actions or determinations described below, whichever is later. Using the input received from management, the SR Directorate will update the followup system expeditiously. The required input information is:

- a. Dates of completion for previously agreed-to but incomplete actions.
 - b. Revised target date when original target date provided during the audit utilization process cannot be met. Revised target dates require responsible AAG approval.
 - c. Modification of previously agreed-to actions, with sufficient detail to enable the Audit Service to determine whether the finding can be listed as closed or whether it needs to be reclassified.
 - d. Final determination of potential monetary benefits previously undetermined in the utilization process.
 - e. Resolution of previously undecided finding and/or recommendation.
4. The responsible AAG will correspond with management and, either the AAG or the SR Directorate will correspond with the Naval Inspector General, to acknowledge closeout decisions and extensions on followup actions.

705 -- FOLLOWUP AUDITS

1. General.

- a. In addition to the followup on prior recommendations that is done, where applicable, on every audit, separate followup audits are sometimes scheduled. Followup audits can have two objectives for each recommendation followed up on. These include determining whether:
 - The recommendation addressee did what was agreed to, or took some equally acceptable alternative action(s), and agreed-to savings were achieved. Paragraph [608](#) provides guidance on savings/benefits.
 - The action(s) taken eliminated or at least significantly corrected the reported deficiency.

The first objective can usually be accomplished in a short time, so it will be used for each recommendation subjected to a followup audit. However, the second objective is often resource intensive. For example, determining whether management issued a policy instruction, as recommended, usually takes little time, but determining whether that instruction entirely corrected or contributed to a significant improvement in a reported deficiency might take much more time. Therefore, decisions as to whether to undertake

the second objective for individual recommendations will be made on a case-by-case basis by the applicable AAG in consultation with the SR Directorate. If the AAG determines that considerable audit hours are required to accomplish the second objective, and if it is practical to wait until the next audit to do the work, only the first objective will be authorized.

- b. Preferably, followup audits should be performed no later than 1 year after management indicated they completed the recommended action(s). When auditors find that management has taken partial or no corrective actions, they should ascertain whether management was aware of the status of the previously reported findings, and determine what actions, if any, are currently planned to implement the recommendations. Such findings will be reported as repeat findings and will be addressed to the next highest level for resolution.³⁵ The results of followup audits will be processed and reported on in the same manner prescribed for other audits. Such reports should receive full distribution unless otherwise approved in advance by the AAG. Results of followup audits with no recommendations or with no adverse conditions to report will be in the form of a letter report.

2. Responsibilities.

- a. After report publication, AAGs should ensure comments are entered in DAMIS as to which findings and recommendations are recommended for followup, together with an estimate of the audit hours required, the locations involved, and the travel dollars needed.
- b. As a general rule, AAGs will select and schedule followup audits. The SR Directorate may recommend followup audits. If deemed appropriate by the AAG, a potential followup audit may be preceded by general research. When a decision is made to do a followup audit, a PPW will be prepared and included in DAMIS.
- c. When the responsible personnel have coordinated on a start date for a followup audit, the PM will issue an announcement letter and initiate performance of the audit. The Naval Inspector General (NAVINSGEN-04) will be provided a copy of all followup announcement letters. Chief of Naval Operations (Code N09B) will be provided an information copy of followup announcement letters concerning Chief of Naval Operations activities. The Commandant of the Marine Corps (Code RFR) will be provided an information copy of the followup announcement letters concerning Marine Corps activities.

3. Criteria for followup. Findings and recommendations meeting one or more of the following criteria should be considered for followup.

- Findings and recommendations involving significant monetary benefits.
- Findings and recommendations identifying *material* internal control weaknesses.

³⁵ Findings over 5 years old (from publication date of the report) should not be classified as repeat but should be written as new findings calling attention to the fact that a similar finding was previously reported in Audit Report Number xxxxx, dated xxxxx.

- Significant findings and recommendations, initially unresolved, which were resolved in favor of the Audit Service position.
- Repeat findings.
- Findings and recommendations with potential violations of Title 31, U. S. Code, Section 1301(a), and Title 31, U. S. Code, Section 1517.
- Findings concerning suspected fraud and other criminal acts.³⁶
- Findings or recommendations that likely will arouse public concern or congressional interest.
- Findings and recommendations of known interest to senior Department of Defense and Department of the Navy management.

The Naval Inspector General, Naval Criminal Investigative Service (NCIS), Department of the Navy management, AUDGEN/DEPAUDGEN, SR Directorate, or AAG responsible for the initial audit may nominate an entire audit report or selected findings and recommendations for followup. An audit may be scheduled depending on the significance of the issue(s), program(s), or function(s), and the related risks and priority.

³⁶ A decision to follow up on these findings will consider recommendations from the Naval Audit Service Counsel and the Naval Criminal Investigative Service.

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PART I -- GENERAL POLICIES

The Naval Audit Service must accomplish audit reporting in accordance with Generally Accepted Government Auditing Standards (GAGAS), as supplemented. The supplemental guidelines are generally an amplification or clarification of GAGAS. Reporting guidelines, which address form, timeliness, distribution, content, and presentation, are discussed in the following paragraphs.

801 – FORM

If the audit effort reaches a conclusion on one or more of the objectives of an audit, a formal numbered audit report (standard format or letter format) should be issued. Paragraphs [806](#) and [822](#) contain related guidance. Oral communication to appropriate officials is not a substitute for written reports.

802 – TIMELINESS

- 1. Criteria.** Reports are to be issued on or before any dates specified by law, regulation, or special arrangement.
- 2. Milestones.** To be of maximum use, reports and opinions must be issued timely with particular emphasis on management's need for the information. The estimated date for report publication will be included in the Department of the Navy Internal Audit Plan (paragraph [303.4a\(1\)](#) applies). Assistant Auditor Generals will establish and monitor milestones for timely issuance of audit reports.
- 3. Interim informal reporting.** Interim informal reporting (such as briefings, verbal or written, and point papers regarding audit progress and individual findings) and utilization are to be used to the extent reasonable (paragraph [618](#) applies). In this manner, the auditor can give operating managers, and other interested parties, an opportunity to initiate corrective action and provide feedback to the auditor as soon as problems are identified rather than at the end of the audit.
- 4. Immediate formal reporting.** Quick reaction reporting and Auditor General Advisories may be used for significant matters that require immediate, formal reporting to senior Department of the Navy (flag-level or Senior Executive Service) attention (paragraph [613](#) applies).

803 – DISTRIBUTION

- 1. Utilization reports.** Utilization (draft) reports, approved in writing by the Assistant Auditor General, are to be provided electronically to the lowest level Command/Activity/Program Manager that can take corrective action. Exceptions to the electronic distribution rule include classified reports and other reports containing sensitive information. Copies should be provided electronically to managers two echelons above the auditee level but no higher than the Assistant Secretary of the Navy level. Copies may also go to other audited commands/activities and other interested parties that are authorized to receive the report. Interim/utilization reports may not be

released outside the Department of the Navy without the prior approval of the Auditor General of the Navy.

2. Final reports. Final written reports are to be submitted electronically to (1) the Commanding Officer/Program Manager of the program, function, or activity audited, (2) officials who requested an audit, (3) all officials responsible for corrective actions, and (4) all other interested parties authorized to receive such reports, including managers two echelons above the auditee level but no higher than the Secretary of the Navy level. Again, exceptions to the electronic distribution rule include classified reports and other reports that contain sensitive information. “Copy to” distribution should be included as a separate report appendix. The appendix is entitled “Others Receiving Copies of this Report.” Unless restricted by law, Office of Management and Budget/ Department of Defense guidance, or Department of the Navy Instructions, copies must be made available for public inspection under Freedom of Information Act procedures. The [“Report/Announcement Letter Distribution and Coordination List”](#) provides details on audit report distribution, including distribution of reports related to the Defense Finance and Accounting Service and other Defense Agencies, and those related to the DON Chief Information Officer.

3. Final reports with recommendations to Defense Agencies. In accordance with various Statements of Policy issued by the Office of the Assistant Inspector General for Policy & Oversight, DOD (OAIG-P&O), the Office of the Assistant Inspector General for Auditing, DOD (OAIG-AUD) will distribute all Naval Audit Service audit reports that address recommendations to the Defense Finance and Accounting Service (DFAS) or other Defense Agencies. For all final reports where recommendations are made to any Defense Agencies:

- a. The report recommendations will be addressed to the Director, (Defense Agency).
- b. The report will be transmitted electronically to the OAIG-AUD via separate cover letter. The OAIG-AUD will review and endorse the recommendations and forward the report to the Defense Agency. Once the OAIG-AUD forwards the final report to the Defense Agency, the report will be placed into the IG, DOD followup system.
- c. The transmittal memo to OAIG-AUD should contain the following statement: This report includes recommendations to (Defense Agency). We are providing this report for your review in accordance with policy issued by the Assistant Inspector General for Policy and Oversight, DOD on 27 November 199x.³⁷ After your review, please forward the report to (Defense Agency) and inform us of your action. Should you have questions or require additional information, please contact (name of the applicable Project Manager (xxx) xxx-xxxx).

804 – CONTENT OVERVIEW

1. The report should include, where appropriate:
 - a. A description of the audit objectives, scope, methodology, and timeframes.

³⁷ Cite 27 November 1991 for recommendations to all Defense Agencies other than Defense Finance and Accounting Service, for which we should cite 27 November 1992.

- b. Background information on the program, activity, or function being reviewed.
- c. A statement that the audit was made in accordance with GAGAS, or full disclosure including reasons why, when applicable standards were not followed.
- d. Disclosure of the current status of corrective actions taken by management in response to recommendations in prior reports that affects the current audit objectives.
- e. Disclosure of all significant instances of noncompliance.
- f. A statement that laws, regulations, and DOD/DON guidance applicable to the items tested were (or were not) complied with and, if appropriate under the circumstances, a statement that the auditor has no reason to believe untested items were not in compliance.
- g. A statement as to whether any pertinent information has been omitted because it is deemed privileged. The nature of such information should be described, and the law or other basis under which it is withheld should be stated. If a separate report was issued containing the information, that fact must be indicated.
- h. A statement on the internal controls existing and the controls evaluated; full disclosure on material weaknesses found; and an opinion on the adequacy and effectiveness of the internal controls related to the audit objectives.
- i. **A statement indicating whether the weaknesses identified are significant enough to be considered for reporting in the next SECNAV Annual Statement of Assurance.**
- j. A specific conclusion on each stated audit objective.
- k. Photos, charts, graphs, exhibits, and appendixes that contribute to the clarity of the report
- l. Copies of financial statements reviewed (applies to financial statement and financial related audits as defined by the Comptroller General of the United States); an opinion on the financial statements, when appropriate; a statement on informative disclosures included in the financial statements; and the degree of responsibility being taken for financial and operational summaries included in the report (state whether or not statements provided by auditees were audited). [Chapter 9](#) "Financial Audit Reports" discusses the contents of a financial or financial related audit.
- m. Informative discussion of audit findings, auditor conclusions, and potential monetary benefits, when applicable. **Underlying causes of problems reported, including the reason that management was not complying with regulations, must be included to assist in implementing corrective actions.** If data are significant to the audit findings and conclusions, but are not audited, the report should clearly identify the data's limitations and unwarranted conclusions or recommendations based on those data should not be made. The report should clearly indicate why information, which is crucial to the conclusions reached, is based on testimonial evidence.

- n. Specific and realistic recommendations for corrective actions that deal with underlying cause(s) of problems identified.**
 - o.** Pertinent views of responsible officials of the program, function, or activity audited concerning the auditors' findings, conclusions (inclusive of potential monetary benefits and material internal control deficiencies), and recommendations.
 - p.** Management's comments presented in their entirety and verbatim, including letterhead and signature blocks, as an appendix.³⁸ In all cases, the management response section(s) of each finding will contain the essence of management's responses and will be annotated to indicate that verbatim comments are included in the report as an appendix.
 - q. Full disclosure of management and audit positions on unresolved issues.**
 - r. A description of significant noteworthy accomplishments identified within the scope of the audit,** particularly when management improvements in one area may be applicable elsewhere.
 - s.** A list of significant issues that warranted further audit work but were not directly related to the audit objectives, if an Assistant Auditor General decision was made to consider them in planning for future audit work.
 - t.** A list of the audit team members as the last exhibit.
 - u.** Information on how to obtain copies of the report and how to request future audits.
- 2.** When an investigation or fraud referral results from the audit, other reporting issues must be considered.
- a.** The method of reporting audit results to appropriate management officials shall be guided by the situation and individual circumstances surrounding any suspected or potential fraud disclosed through audit and will be determined in coordination with the investigative agency to which the matter is referred. A separate audit report on the evaluation of the internal controls related to the matter referred to the investigative agency can be used, if necessary, to avoid delays in issuing the overall audit report. This also permits release of the overall report without compromising an investigation or legal proceeding.
 - b.** A separate report is not necessary when the matter can be effectively discussed in the regular audit report, and no undue delay will result from holding the audit report open until the fraud referral has been resolved. The auditors shall not release to the public reports containing information on suspected fraudulent acts, or reports with references that such acts were omitted from reports, without first consulting with the Naval Audit Service legal counsel. Such release could interfere with legal processes, subject the

³⁸ *Exceptions due to lengthy (voluminous) comments from a single command should be rare and require the approval of the responsible Assistant Auditor General.*

implicated individuals to inappropriate publicity, or subject the auditor to potential legal action.

805 – PRESENTATION

The report should be complete, accurate, objective, convincing, clear, and concise. In adhering to this policy, the auditor will consider the following:

1. Completeness. Reports must contain sufficient pertinent information to (1) satisfy the audit objectives, (2) promote an adequate understanding of all matters reported, and (3) meet the applicable report content requirements. The degree of detail may vary with the complexity of the issues addressed and the degree to which management accepts the facts, conclusions, and recommendations.

2. Accuracy. Only information, findings, opinions, and conclusions that are supported by competent and relevant evidence in the auditor's working papers should be included.

3. Objectivity. The report should be fair and not misleading and the results should be presented impartially, without overemphasis or exaggeration. Comments should be presented in a balanced perspective considering any unusual difficulties or circumstances faced by operating officials. **Audit reports should specifically avoid language that unnecessarily generates defensiveness and opposition. The tone of the report should emphasize needed improvements rather than dwell on criticism of past performance. Reports should be positively focused giving credit for things well done.**

4. Convincingness. Audit results must be presented in a manner that is persuasive and responsive to the audit objectives. Conclusions must flow logically from the facts presented. All statements must carry the assurance that the auditor personally validated or observed the facts or be clear as to the source or basis of information presented.

5. Clarity. Reports should be written in language easy to read and understand. Logical organization of material, and accuracy and precision in stating facts and in drawing conclusions, are essential to clarity and understanding.

- a. To highlight the logical relationships in the information presented, auditors should organize sentences in paragraph-subparagraph arrangements, in which main ideas or conclusions are presented in main paragraphs and supporting details follow in subparagraphs. For this reason, individual paragraphs or subparagraphs should generally not exceed 15 lines.
- b. The use of jargon and technical terms should be avoided or, if considered essential, clearly defined. In the rare instances where use of jargon and technical terms is required by the nature of the subject matter, the terms and their definitions will be included in a Glossary (paragraph [843](#) applies), or explained in footnotes.
- c. To facilitate an effective and consistent reporting style, the current versions of Secretary of the [Navy Instruction 5216.5, especially Chapter 3, *Naval Writing Standards*](#), and the

[Government Printing Office Style Manual](#), are to be used. These documents provide guidance not only on style and format but on areas such as capitalization, spelling, compound words, punctuation, abbreviations, and italics.

- d. Visual aids such as schedules, charts, tabulations, photographs, and graphs should be used for clarification or considered as alternatives to lengthy discussions.³⁹
- e. Gender neutral terminology will be used in reporting.

6. Conciseness. A report should be no longer than necessary to be understood by users and third parties. However, care must be taken to ensure that conciseness is not overemphasized to the point that writing is reduced to an abrupt, telegraphic style. It is essential to maintain a continuity of thought, an ease of reading, and a comfortable, integrated flow of ideas. Findings and recommendations should also supply sufficient detail for operating managers to be fully aware of the condition, its implications, and the suggested remedial action.

806 -- CATEGORIES OF REPORTING

One or more of the following methods is used to communicate results of audit efforts to Department of the Navy management and other interested parties.

- 1. Standard reports.** These are formal written reports designed to satisfy audit objectives, communicate material findings (**positive or negative**), summarize nonmaterial findings, and meet the applicable report content requirements of paragraph [804](#). [Chapter 9](#) provides special reporting requirements for financial audits.
- 2. Letter reports.** These are formal written reports designed to summarize any nonmaterial findings disclosed by audit or verify an absence of adverse conditions within the announced audit objectives and scope. Paragraph [822](#) provides related guidance. Letter reports are used when a standard report would provide little additional service to management.
- 3. Quick reaction reports.** These reports provide interim, **formal** reporting on serious problems or sensitive issues which cannot be corrected by the Commanding Officer/Program Manager under review and, therefore, require immediate reaction by more senior DON management. Quick reaction reporting may be initiated during the survey/verification phases of an audit. Normally the circumstances addressed in a quick reaction report will be included later in a standard audit report. Paragraph [613](#) provides additional guidance concerning quick reaction reporting. Paragraph [802.3](#) discusses interim **informal** reporting mechanisms that might be used to accomplish the same objective depending on the circumstances.
- 4. Draft findings and draft reports.** Transmitting draft findings and draft reports is one interim method of advising management of potential deficiencies identified during the audit. Interim reporting ensures that management has been advised in writing of all deficiencies, including those minor deficiencies excluded from the final report. Paragraph [618](#) provides additional guidance. **Managers should normally be briefed or receive other notification of**

³⁹ This information should be provided to the editors in simple format so that they can enhance it in a way that conforms to our style and is compatible with our publishing software.

preliminary audit results as soon as a problem is identified and before written findings and reports are issued (paragraph [802.3](#) applies).

5. Auditor General advisory. This format is used to provide information to senior DON management (Secretariat, flag-level, and/or Senior Executive Service) for use in developing solutions to problems of a systemic or continuing nature or having Department of the Navy-wide interest. **An advisory is not an audit report.** The problem or sensitive issue addressed in an advisory may have been included in previously published Department of the Navy, Department of Defense Inspector General, and/or General Accounting Office audits and/or may be the subject of ongoing audits or current public/Congressional interest. An Auditor General advisory can only be issued with the approval of the Auditor General of the Navy. Auditor General advisories will follow the same editorial review process as an audit report.

6. Auditor General opinion. This is a written position on (1) an accounting principle or auditing standard, (2) the application of an accounting principle or auditing standard within the DON, or (3) specific reporting requirements applicable to Department of the Navy financial or performance audits. An Auditor General opinion can only be issued with the approval of the Auditor General of the Navy. Auditor General opinions will follow the same editorial review process as an audit report (paragraph [854](#) applies).

7. Internal and external quality control reviews. These reviews are designed to determine whether Department of the Navy audits, both internal and external, are performed in compliance with government auditing standards as supplemented by the Department of Defense Inspector General and the Naval Audit Service and, when applicable, with contractual requirements (paragraph [203](#) applies). Formal reports are issued that address each review objective. Internal and external quality control reviews will follow the same editorial review process as an audit report (paragraph [854](#) applies).

807 -- CRITERIA FOR STANDARD REPORTS

Only material findings will normally be included as fully developed findings with recommendations in standard audit reports. Using professional judgement and common sense, Project Managers, Audit Directors, and AAGs must decide materiality on a case-by-case basis. However, findings involving one or more of the following conditions or situations will usually be considered material and included in standard audit reports.

- Material internal control weaknesses. Large dollar amounts (generally, instances involving \$250,000 or more in assets).
- Net potential monetary benefits of \$10,000 or more.
- Potential fraud, other criminal acts, or improper practices (paragraph [615](#) applies).
- Substantial violations of program directives or poor management practices that could seriously affect (or perhaps already have affected) program accomplishment.
- Major inefficiencies in the use of resources or management of operations.

- Significant program-performance issues.
- Major policy or procedure changes in the Department of the Navy or Department of Defense.
- A major impact on readiness, security, morale, or welfare.
- Events or conditions likely to result in a high degree of notoriety or potential embarrassment.
- Extensive minor deficiencies that, as a whole, are significant.
- Repeat conditions less than 5 years old.
- Undecided issues or nonconcurrences on either potential monetary benefits or recommendations.

PART II -- GENERAL FORMAT

808 – FLEXIBILITY

The Naval Audit Service is continually striving for excellence in reporting. In keeping with this goal, the report format may be changed to meet special circumstances of an audit, to satisfy unusual reporting situations, or to eliminate unnecessary redundancy. Any format used must address conclusions first (normally in the summary of results as part of an Executive Summary) as well as the essential areas of background, objectives, scope, methodology, and status of recommended actions and potential monetary benefits (Section C). All reports must contain both verbatim management comments and Audit Service comments.

809 – FORMAT AND SEQUENCE

1. Performance audits. Each standard audit report should be in the following format and sequence:

- a. Cover.
- b. Transmittal letter.
- c. Table of Contents.
- d. Executive Summary.
- e. Section A - Introduction, including Background, Objectives, Scope, and Methodology.

- f. Section B - Findings and Recommendations, Management Responses, and Audit Service Comments.
- g. Section C - Status of Recommended Actions and Potential Monetary Benefits.
- h. Exhibits, Appendixes, and Glossary (if needed).

Paragraphs [810](#) through [842](#) provide step-by-step guidance on preparing the audit report.

2. Financial and financial related audits. Additional form and content requirements for audit reports performed in accordance with the Chief Financial Officers Act of 1990 are identified in [Chapter 9](#).

810 -- COVER

1. Standardization. The audit cover will include the audit title, publication number provided by the editors, report date, and protective markings, if appropriate.

2. Audit title. The audit title should describe the subject of the audit report. It need not be the descriptive title included in the Department of the Navy Internal Audit Plan or the audit announcement letter. Changes in titles usually result from changes in audit objectives or scope and the auditee should be advised of such changes as they occur. Report titles should not contain the terms "A Review of...", "An Audit of...", "Navy-wide Audit of...", or "Department of Defense-wide Audit of..." **Report titles should not promise more than the report discusses.** If many programs, issues, and functions were audited, the report title should provide an accurate idea of the most important matters dealt with in the audit. The title may identify the activity or command involved in the audit. As a general rule, if a Department of the Navy-wide function or more than two activities or commands were involved in an audit, no activities should be identified in the report title. For those audits that were conducted at two or more activities but were not Navy-wide, the title should state, "at Selected Activities." For example, "Major Procurement at Selected Activities." Additionally, acronyms or other technical terms must not be used as part of the audit report title. The following are examples of proper report titles:

- Marine Corps Mobilization Planning
- Major Procurement at (Naval Activity)

Throughout the audit report and in subsequent correspondence, the audit should be referred to by the report title with the publication number in parentheses.

3. "FOR OFFICIAL USE ONLY" markings. Naval Audit Service audits may deal with information that is not releasable under the Freedom of Information Act and is "FOR OFFICIAL USE ONLY" (FOUO). This information includes personal information and business sensitive or propriety data. An audit report that contains FOUO information shall have "FOR OFFICIAL USE ONLY" printed in capital letters, centered at the bottom on the outside of the front and back cover. In addition, include the following statement on the front cover:

NOTICE

This report contains information exempt from mandatory disclosure under the Freedom of Information Act. Exemption x⁴⁰ applies.

In addition to cover markings, each page containing FOUO information will be marked "FOR OFFICIAL USE ONLY," centered at the top and bottom of each page.

811 -- TRANSMITTAL LETTER

- 1. Content.** The transmittal letter will be limited to the items identified in paragraphs 2 through 10 below. Summaries, conclusions and details found elsewhere in the report will not be duplicated in the transmittal letter. The transmittal letter should be kept to one page whenever possible.
- 2. Title and date.** The transmittal letter will show the same title and date as the report cover.
- 3. Audit job order and report numbers.** The audit job order number will appear in the upper right hand corner following the file reference. The audit report number will be included in the subject line of the letter and will be the same number as on the report cover. Audit report numbers are to be obtained from the editors just prior to publication and after incorporating report changes required as a result of pre-publication review. AAGs approve the release of reports.
- 4. Addressee.** The transmittal letter will use the "Memorandum For" format to list the addressees.
- 5. Notice of status-reporting requirement.** The transmittal letter must point out that the addressee(s) is required to provide a status report to the Auditor General of the Navy (Attn: the responsible Assistant Auditor General and the Assistant Auditor General for Strategic Sourcing and Resources Management (SR-24)) within 30 days after the target completion date for each "open" recommendation in accordance with [Secretary of the Navy Instruction 7510.7\(Series\)](#). For reports addressed to Marine Corps activities, the transmittal letter must point out that the Commandant of the Marine Corps has this responsibility (as opposed to the auditee). Action copies of reports concerning the Office of the Chief of Naval Operations should be addressed to the Chief of Naval Operations (N09B). For reports with recommendations to a Defense agency, a statement should be included discussing what written status reports are required. [DOD Directive 7650.3](#) provides additional details.
- 6. Undecided issues and repeat findings.** If report recommendations or potential monetary benefits are undecided or a report contains a repeat finding, the letter will be addressed to cognizant immediate superior(s) in command for those issues. The letter must clearly indicate

⁴⁰ Generally, exemption 4, (privileged information, i.e., trade secrets and commercial information), 5 (pre-decisional inter-agency or intra-agency memorandums or letters or government business data whose release would cause the government competitive harm) or 6, (personnel, medical and similar files) apply. However, if these exemptions do not apply or there is some confusion as to which exemption does apply, consult with the Naval Audit Service Legal Counsel.

that the immediate superior in command is **required** only to provide comments on the undecided recommendation(s) or potential monetary benefit(s), and/or repeat findings, but may comment on other aspects of a report, if desired. If undecided issues are elevated to the Under Secretary of the Navy, the letter will: (1) be addressed to the Under Secretary of the Navy and the Naval Inspector General; and (2) state that the Naval Inspector General has these undecided issues for action as the facilitator, as required by [Secretary of the Navy Instruction 5200.34\(Series\)](#). In this instance, the letter should also state that the immediate superior in command is required by [Secretary of the Navy Instruction 7510.7\(Series\)](#) to provide a status report to the Auditor General of the Navy (Attn: the responsible Assistant Auditor General and the Assistant Auditor General for Strategic Sourcing and Resources Management (SR-24)) within 30 days of the report issue date. The AUDGEN should be notified before an issue is elevated to the Under Secretary.

7. Restrictions on use of report. Clearly identify any important restrictions on use of the report information (for example, it contains classified or business-sensitive information).

8. Freedom of Information Act requests. Management will be advised that any requests for the report under the Freedom of Information Act must be approved or denied by the Auditor General of the Navy as required by [Secretary of the Navy Instruction 7510.7\(Series\)](#).

9. Reference to followup. Point out the followup provisions of [Secretary of the Navy Instruction 7510.7\(Series\)](#). If recommendations are made to a Defense agency, reference should be made to [DOD Directive 7650.3](#).

10. Stationery and signature. The transmittal letter will be on Naval Audit Service letterhead stationery and will be signed by the responsible Assistant Auditor General or Audit Director.

812 -- TABLE OF CONTENTS

List all major sections, subsections, exhibits, and appendixes.

813 -- ACRONYMS

While there may be circumstances where the use of acronyms is unavoidable, their use shall be kept to a minimum. When the use of numerous acronyms is essential, they will be listed and defined on the inside front cover for easy access by the reader.

PART III -- EXECUTIVE SUMMARY

The Executive Summary gives managers a capsule report on the audit. The length of an Executive Summary is subject to professional judgement but generally should not be more than one to two pages. One page is preferred. The Executive Summary normally consists of:

- a. A brief **Overview** of the general nature of the audit. If needed, this section will provide general background information required to understand the rest of the Executive Summary.

- b. A **Conclusions** section that summarizes audit results (both **positive and negative**) within the framework of the audit objectives and provides a conclusion on each objective.
- c. A **Corrective Actions** section that briefly describes what management has agreed to do to correct problems identified by the auditors and the status of audit recommendations that management does not agree with. While use of "Overview," "Conclusions," and "Corrective Actions" headings are generally encouraged, they are not required, and the information does not have to be presented in that sequence.

814 -- OVERVIEW

This section, normally a paragraph, should:

- a. Provide a few sentences of background, if they enhance the reader's ability to appreciate or understand the audit results.
- b. Advise that conditions reviewed existed during the period (month/year to month/year). **It is important that the reader be aware in the Executive Summary that some of the conditions found may no longer exist as of the publication date of the report.**

815 – CONCLUSIONS

1. Purpose. The primary purpose of the conclusions section is to present the audit results within the context of the audit objectives. The section also contains conclusions on the adequacy of the internal control system and compliance with regulations in the audited area, as well as other information.

2. Presentation. The conclusions section should normally be presented as a series of modules, with a module on each objective. Such modules should include:

- a. A conclusion.
- b. Support for the conclusion, which is normally a summary of the relevant audit findings or other audit results. Within each module, pertinent findings should be discussed. Discussion of the causes and effects of conditions is often beneficial but not always required. Findings that support the same conclusion and findings that have the same cause or effect should generally be summarized as a group rather than individually. Each module should use a narrative approach that discusses audit results within the framework of the objectives, rather than simply list the initial, or "Synopsis" paragraphs from the finding(s) pertaining to the conclusion.

3. Conclusions on internal controls. A conclusion on the adequacy of the internal control system for the audited area must be presented in the conclusions section. **Material internal control weaknesses related to the audit objectives should be identified.** By definition, a material internal control weakness is a reportable condition. The auditor must also consider the cumulative effect of nonmaterial internal control problems, and, based on professional judgement, may combine such occurrences and report them collectively as a material weakness.

4. Other information. The conclusions section should also contain:

- a. A discussion of significant instances of noncompliance or a statement that reviewed areas were found to be in compliance. Also, if appropriate under the circumstances, there should be a statement that we have no reason to believe untested items were not in compliance.
- b. **A description of any significant noteworthy accomplishments**, particularly when management improvements in one area may be applicable elsewhere.
- c. Issues needing further study (an example would be an issue outside the scope of the current audit) and the reasons supporting further study. However, do not use language that commits the Audit Service to future audit work or any other specific course of action.
- d. A comment on other matters such as special reports issued or in process, if those matters make the report more meaningful.
- e. If applicable, a comment on recommendations followed up on from prior audits with a summary of results. If any repeat findings (within the last 5 years) were noted, they should be identified and briefly discussed. Do not discuss prior audits here if there was no prior audit of the subject being audited, or no repeat findings. If the prior report was issued more than 5 years before the current audit began, a finding should not be considered as a repeat, even if it represents substantially the same condition that was previously reported. Paragraphs [409.2](#), [703](#), and [820.10](#) provide related guidance.
- f. If applicable, a summary of nonmaterial findings and a statement that they will be reviewed during the next audit. The referral should be in general terms. For example, the following sentences may be used: "During the audit, the following nonmaterial issues were found (....). Details concerning these issues were provided to the Commanding Officer/Program Manager. The Commanding Officer/Program Manager agreed to take corrective actions. These issues will be reviewed during the next audit to confirm that agreed-to corrective actions were taken."

5. Special requirements for financial and financial related audits. If the audit is a financial or financial related audit, special requirements for reporting audit results apply. These are described in [Chapter 9](#).

816 -- CORRECTIVE ACTIONS

This section should *briefly summarize* management's position on the audit recommendations and the corrective actions taken. Also describe the status of the resolution process for the recommendations that management has not agreed to.

817 – FEDERAL MANAGERS' FINANCIAL INTEGRITY ACT (FMFIA)

This section will be added when the audit identifies material weaknesses that should be considered by management for inclusion in the SECNAV's Annual Statement of Assurances. The section will cite "The Federal Managers' Financial Integrity Act (FMFIA) of 1982, as

codified in Title 31, United States Code, requires each federal agency head to annually certify to the effectiveness of the agency's internal and accounting system controls." The section will then cite the specific recommendations which address corrective actions needed to improve the effectiveness of internal (management) controls, followed by our opinion that the identified weaknesses are material FMFIA Section 2 issues which will be considered for inclusion in our annual memorandum of material internal control weaknesses to the Secretary of the Navy.

PART IV -- SECTION A

This section contains the background information, and descriptions of the audit objectives, scope, and methodology.

818 – BACKGROUND

- 1. Introductory information.** The report must present information needed to introduce the audit to general readers in such a manner that they will understand and appreciate the subject being audited and the audit results. The background section should describe functions and/or responsibilities, and mission of the audited program, system, or activity. It should focus on those aspects that relate directly to the audit objective(s). For example, if the subject of the audit is inventory management of sonobuoys, the background information should explain why sonobuoys and management of the sonobuoy inventory are important to the Navy.
- 2. Perspective.** To give the reader some perspective on the size and scope of the resources covered by our audit, the background section should provide financial and operational information. If the audit was of a particular program and was conducted at a number of locations, we should note the dollar value of the entire program. The amount and type of appropriated funds for the activity(s) or function(s) audited must be shown. The information contained in the background section should primarily provide highlights of the financial and operational information. A financial profile and/or operations summary gives the perspective the reader needs to appreciate and understand the audit results as well as the activity audited.
 - a. Financial profile.** A financial profile presents data to give the reader an overview of the financial position of the organization, program, activity, or function audited.
 - b. Operations summary.** An operations summary gives the reader a greater appreciation for the size and diversity of the activity, program, subject, or function audited. For functional audits, each major function of the activity should be addressed (irrespective of whether a finding was developed) by giving general information about overall resources and transactions. Subfunctional areas should be used as a basis for selecting information presented in the report. For example, on an audit of the supply function (which includes the subfunctions of stock control, material receipt and issue, storage, and physical inventory), data such as the inventory value, number of line items stocked, and the

number of requisitions processed monthly should be included in the operations summary.⁴¹

3. Other information. The following types of additional background information should also be included, if appropriate:

- a. The number of U.S. military and civilian employees assigned to the audited activity or function, and for audits performed in foreign countries, the number of foreign nationals.
- b. A chart or appendix showing important life cycle milestone dates for acquisition program and information system audits.
- c. An explanation of any unique procedures the activity uses and any unique circumstances that exist so that, when readers read audit findings about these procedures and circumstances, they will be able to fully understand the findings.
- d. A statement that the audit is part of a Department of Defense-wide audit.
- e. For command request audits, an explanation of who requested the audit and why (if the reason is known), and a description of any circumstances leading to, and terms of, the request (such as a Department of Defense hotline allegation).
- f. If a glossary is not used, definitions for any technical words or peculiar phrases should be presented in readily understandable terms so uninformed readers will understand the information presented.

819 -- OBJECTIVES

The statement of objectives tells the reader why the audit was conducted and states what the audit set out to accomplish. Common objectives for various types of audits are presented in paragraph [420.1](#).

1. Management request. A specific objective(s) arising from a command request should be included in an audit unless inclusion would be contrary to Department of the Navy policy or would violate an audit standard. For example, if a management request is to evaluate the cost-effectiveness of recommissioning a certain battleship, the "Background" part of Section A should include any known pertinent facts leading to the request; and the "Objectives" part of Section A should include the specific objective(s) requested (such as ascertaining whether costs incurred were valid). The specific costs and functions to be reviewed should be included in the "Scope" segment of Section A.

2. Propriety in wording. An audit objective(s) must be attainable; that is, after doing the audit we should be able to answer the question(s) posed by the objective(s). Thus, care should be taken to state the objectives accurately.

⁴¹ *Financial profiles and operation summaries should include a statement as to the source of the information.*

3. Performance audits. Performance audit objectives generally relate to whether the activity is managing and utilizing its resources effectively and/or achieving its goals. Such objectives might be designed to: assess the adequacy of management's system for measuring efficiency and/or effectiveness of a program; determine the extent to which a program achieves a desired result; determine whether the activity has considered alternatives that might yield lower costs; and, identify factors or weaknesses hindering satisfactory or desired performance.

4. Financial audits. Financial audit objectives might be designed to determine whether the audited activity's financial statements fairly present the financial position and financial operating results in accordance with generally accepted accounting principles. Paragraph [905](#) provides additional guidance on objectives related to financial audits.

5. Internal controls. The evaluation of internal controls or review of the auditee's Management Control Program will be stated as an objective only if that is a primary purpose of the audit. **All audits will evaluate whether internal controls applicable to areas audited were adequate to prevent or detect material errors and irregularities in operations and that operations were in compliance with applicable laws, regulations, directives, or instructions.**

6. Computer-based systems. When auditing computer-based systems, additional objectives must be considered to determine whether:

- a. General controls⁴² have been designed according to management direction and known legal requirements.
- b. General controls are operating effectively to provide reliability of, and security over, processed data.
- c. Application controls⁴³ are reliable and data are processed in a timely, accurate, and complete manner.

Paragraph [611](#) provides related information.

820 -- SCOPE

The scope section tells the reader what the auditors did to accomplish the audit's objective(s). The scope should report the kinds and sources of evidence and explain any quality or other problems with the evidence. The scope should reflect the extent of reliance on the work of others if that work is the basis for conclusions relative to audit results and objectives. The scope should also discuss any impairment and its effect on audit conclusions. Auditors should attempt to avoid misunderstanding by the reader concerning the work that was and was not done to achieve the audit objectives. The scope should, as applicable, provide:

⁴² General controls are the structure, methods, and procedures that apply to the overall computer operations in an agency. They include organization and management controls, security controls, and system software and hardware controls.

⁴³ Application controls are the methods and procedures designed for each application to ensure the authority of data origination, the accuracy of data input, integrity of processing, and verification and distribution of output.

1. Definition of audited universe. Scope should describe the relationship between the universe and what was audited within the stated audit objective(s). For example, "We reviewed "X" contracts awarded in excess of \$25,000 each, between xx October 19xx and xx September 19xx, with an aggregate value of \$5 billion. During the period under review, there were a total of "X" contract awards valued at \$7 billion."

2. Audit entities. The organizations and geographic locations at which work was conducted should be identified. For example, "Audit work was done at the Office of the Chief of Naval Operations, the Naval Medical Command, the National Naval Medical Center, 11 Naval Hospitals, 4 Naval Regional Medical Commands, and 15 Naval Dental Clinics. A list of activities visited or contacted during the audit is shown in Exhibit A of this report." Describe what audit work was done at each location if the audit work varied by location.

3. Internal control coverage. Scope should describe the evaluation of applicable internal controls. Internal controls may be classified into transaction or event cycles and/or financial statement captions (such as current assets or current liabilities).

- a. For performance audits, the audit report shall identify the significant internal controls that were assessed and the scope of the auditor's work in making that assessment (paragraph [410](#) applies). In seeking the cause of deficient performance, auditors may identify weaknesses in internal controls that are a key reason for the deficient performance.
- b. For financial audits, the auditors shall prepare a written report on their understanding of the entity's internal control structure and an assessment of control risk. The report may be included in either the auditor's report on the financial audit or a separate report when circumstances require. Paragraph [907](#) provides additional guidance. The auditor's report shall include as a minimum:
 - (1) The scope of the auditor's work in obtaining an understanding of the internal control structure and an assessment of control risk.
 - (2) The entity's significant internal controls or control structure, including the controls established to ensure compliance with laws and regulations that have a material impact on the financial statements and results of the financial related audit.
 - (3) The reportable conditions, including material weaknesses, identified as a result of the auditor's work in understanding and assessing the control risk.
- c. If no review of internal controls was performed, the reason for nonperformance must be stated in the scope section of the audit report.

4. Review of Laws and Regulations. Those laws and regulations, which were reviewed for compliance, should be discussed (paragraph [411](#) applies).

5. Request topics. Scope should normally describe audited problem areas that a command/program official discussed at the opening conference and/or asked us to review.

6. Period of transactions covered. The period of operations or transactions covered by the audit must be identified. If the transaction period was not standardized for the audit, show the transaction period for each audit area.⁴⁴

7. Period of audit work. The time period during which audit work was done (month/day/year to month/day/year) must be identified. For reporting purposes, the period of audit will commence with the survey entrance conference date and end when the draft report is issued.⁴⁵

8. Scope restrictions. The report should identify any factor external to the Audit Service and the auditor that restricted the auditor's ability to perform essential audit work and/or report objective opinions and conclusions.

9. Omitted information. The report should state whether any pertinent information was omitted from the report because it was deemed privileged or confidential. The nature, but obviously not the specifics, of such information should be described; the law or other basis under which it was withheld should also be stated. If a separate report containing this information was issued, such as a classified report, reference to that report should be made in this section.

10. Followup. The report should indicate what prior audit reports were followed up on. If there were no pertinent audit reports to follow up on, a statement to this effect should be made. Paragraph [703](#) provides additional guidance.

821 -- METHODOLOGY

The statements on methodology should clearly explain to the reader how the auditors went about accomplishing the audit. Every effort should be made to avoid any misunderstanding by the reader concerning the work that was done and not done by the auditor to achieve the audit objective(s). The description of the methods the auditors used helps the reader evaluate the credibility of the auditors' conclusions. The following issues must be addressed in the methodology section.

1. General approach. Outline how the audit was performed. For example, "examined Naval Research Laboratory policies and procedures, examined selected procurement transactions and financial records, discussed procurement and financial functions with responsible officials, and visited selected field activity sites." Audit programs used to perform an audit should not be cited.

2. Internal controls and compliance. Include a statement that the audit evaluated internal controls and reviewed compliance with regulations. A brief reference should be made to findings related to these areas.

3. Data quality. Discuss what is known about the quality of quantitative data used in the report. The period of time covered by the data used in our analyses should also be clear to the reader. If known, the sensitivity of our results to the quality of management's data and uncertainties about the data should be discussed. If we tested data quality, the nature and results of such tests should

⁴⁴ Care should be taken to ensure that dates cited throughout the report are consistent with the audit period dates cited in the Scope segment of the report.

⁴⁵ Staff hours can be charged to an audit before the survey entrance conference date.

be indicated. When the results of studies done by others comprise an important source of evidence, state what is known about the quality of the data included in the studies and the analytical work that forms the basis of such data, and what analysis we performed to determine this. **Assessment of data quality is especially important for a finding and/or conclusion that relies on studies and/or computer products or outputs as principal support for the finding and/or conclusion (paragraph 412 applies). If data is not reliable, or if doubt exists about its reliability, state the limitations on its use and clearly explain the reasons for the limitations.**

4. Audit analysis techniques. Describe analysis techniques such as:

- a. Statistical sampling and its relevance.
- b. Unique microcomputer applications (other than word processing and spreadsheet analyses) and computer audit retrieval systems.
- c. The use of consultants, experts, or material from other Department of the Navy and/or non-Department of the Navy organizations including any literature search.
- d. The assumptions made and a discussion of the reasonableness of those assumptions.
- e. The use of prior audit reports issued by the Naval Audit Service and by other audit organizations (such as the Defense Contract Audit Agency or the Department of Defense Inspector General), and reports issued by other activities (such as the Naval Inspector General).

Paragraph 606 provides related information.

5. Statement on auditing standards. Most audit reports will state that "The audit was made in accordance with generally accepted government auditing standards." If generally accepted government auditing standards were not followed, this should be stated in the scope segment of the report along with an explanation of which standards were not followed, why, and the effect, if any, on the audit results. The statement need not be qualified when standards that were not applicable were not followed.

6. Criteria used by auditors. State the criteria used for making judgements, if pertinent.

822 -- LETTER REPORTS

1. Appropriate use. An audit will be concluded and a **formal** letter report issued when (1) the audit survey indicates that conditions within the audit objectives and scope are generally satisfactory, (2) a detailed examination would provide little service to management, or (3) verification phase audit efforts verify an absence of adverse conditions within the announced audit objectives and scope. **Such reports will contain positive audit statements and summarize any nonmaterial findings.** It is emphasized, however, that letter reports issued under such circumstances must accurately and adequately describe the basis for concluding that a detailed audit is unnecessary. Paragraph 806.2 contains related guidance. **If material findings are identified (positive or negative), a letter report is not appropriate. Emphasis should be placed on standard reporting, including standard reports with positive findings.**

2. Content guidelines. A letter report will contain sections on Introduction, Background, Objectives, Scope, Methodology, and Summary of Audit Results.

PART V -- SECTION B

Section B will contain the audit findings and recommendations, summaries of management's responses, and Audit Service comments on management's responses. [Chapter 9](#) provides the requirements for a financial audit report.

823 – FINDINGS

1. Definition.

- a. A finding is defined as a logical collection of information leading to conclusions (or a response to an audit objective on the basis of the sum of the information) about an organization, program, activity, function, condition, or other matter that was analyzed or evaluated.
- b. **Each finding has six key components: condition, cause, effect, criteria, recommendation(s), and a description of the methods the auditors used (methodology).**
- c. **Cause is especially important, since the cause identified within a finding will be the basis for an auditor's recommendation(s) for corrective action(s).**
- d. A finding need not be critical or be concerned only with deficiencies or weaknesses, but it must provide readers a complete picture of the conditions (*positive or negative*) disclosed by the audit. **Positive informational findings are encouraged when supported by audit results.**

2. Emphasis on possible improvements.

- a. **The presentation of findings should always give consideration to realistic and reasonable means of improvement or remedy;** failure to do so means that the auditor misses the opportunity to be of real service to management. If auditors are unable to propose a solution for a reported deficiency, there may be no finding at the level at which the audit is being conducted or the auditors may not know what the actual cause is.
- b. **Findings should be written in a dispassionate, objective, and professional manner. Wording that could unnecessarily irritate audited activities should be excluded unless absolutely essential to properly present the audit results or to achieve adequate corrective action. Maintaining a positive tonal quality increases the likelihood that addresses will be receptive to the message the report is trying to convey.**

3. Materiality. As a general rule, only material findings will be fully developed and included in Section B of standard reports. Nonmaterial findings are referred to in the summary section of an audit report (both standard and letter reports). However, before a decision is made on how to report nonmaterial weaknesses, the auditor should determine whether the cumulative effect of these weaknesses is or has the potential of becoming a material weakness. If so, the auditor should develop a separate finding showing the combined material effect of the nonmaterial weaknesses. Paragraphs [402.3](#), [807](#), and [815.4f](#) provide related information.

4. Sequencing. Findings will normally be sequenced in the Executive Summary and in Section B of the report, first by objective and then by order of their significance (mission and/or dollar impact) or in a logical order of how functions are executed. For example, failure to train contracting officers might be sequenced ahead of poor contract administration practices since it lays the foundation for the finding(s) to follow. Each finding will commence on a new page in Section B. When the audit of a functional area or component results in no negative findings, a positive information-type finding should be included if warranted by the audit results. If a positive finding is not warranted, no mention of the functional area need be made in Section B.

5. Internal controls. Where applicable to the finding, auditors must describe **material** internal control weaknesses (paragraph [410](#) applies).

824 -- TITLE

Each finding should be given a title that identifies its subject matter as clearly as possible using a neutral tone. Where appropriate, titles like "Processing requisitions," "Equipment management," and "Inventory controls" should be used, but uniformity should be maintained within the report to the maximum extent possible.

825 -- SYNOPSIS PARAGRAPH

1. The synopsis (lead) paragraph should summarize the condition first, its cause(s),⁴⁶ the criteria by which the audit results can be evaluated, and the effect(s) of the reported condition – inclusive of the potential monetary benefits.⁴⁷

2. The synopsis paragraph must be as concise as possible. Readers quickly lose their ability to focus when presented with unnecessary details. A lead paragraph need not contain all of the information necessary for a reader to completely understand all the specific facts (positive or negative), but it should discuss enough so the reader at least understands the basic conditions. Brevity should not be carried to the point where the reader is forced to read the discussion paragraphs to understand the condition.

⁴⁶ The cause should include the reason management did not comply with regulations in cases in which noncompliance exists. In other words, the finding should state the cause for the noncompliance.

⁴⁷ If we accept management's comments on the amount of potential monetary benefits, this should be reflected in the Synopsis paragraph.

PART VI – DISCUSSION PARAGRAPHS

826 – GENERAL

1. These paragraphs will be read closely by those responsible for implementing recommended actions. Thus, the paragraphs must contain sufficient, competent, and relevant information to promote adequate understanding of the matter(s) being reported (positive or negative) and to provide convincing and fair presentations that are in proper perspective.
2. Discussion paragraphs of a finding will normally contain:
 - a. Minimum essential background information.
 - b. Criteria or standards for the area(s) audited.
 - c. Description of the audit approach.
 - d. Details of conditions found.
 - e. Explanation of the major cause(s).
 - f. Comments on the positive or negative effects the conditions have had or will have on resources or operations - inclusive of potential monetary benefits.
 - g. Comments on any corrective actions taken during the audit in response to the auditors' recommendation(s).
 - h. If applicable, a statement that the finding is a material internal controls weakness.
 - i. If applicable, an indication that the finding is a repeat finding.
 - j. If appropriate, a forecast of how recommended actions will correct reported condition(s).

827 -- BACKGROUND

Background information should be kept to a minimum, but should provide uninformed readers enough information to understand the finding. The amount of information should relate to the complexity of the conditions discussed. The information may be provided in an introductory paragraph or paragraphs, or located with related points in the discussion, or in both places. It's preferable to include some or all of the necessary background information in the background part of Section A. Information should not be repeated unless it's absolutely necessary.

828 -- CRITERIA

1. Criteria (pertinent guidance) are the standards, regulations, rules, or tests by which the audit results can be evaluated. They show "what should be." Paragraph [419.1](#) provides related information.
2. **Agreement on the validity of criteria used should normally be obtained from the auditee as early in the audit as possible.** Within the Department of the Navy, many criteria or standards for operations have been established, but in many areas no formal criteria have been established. In the absence of prescribed criteria, auditors must rely on their professional knowledge and experience to select suitable evaluation criteria. At times, the only criteria available are good business practices. After selecting the criteria, auditors should coordinate with audited management officials to ensure agreement that the criteria are valid. This will increase the likelihood that auditees and other readers of the report will consider audit conclusions reached valid and reasonable.
3. The criteria discussed in a finding should normally be criteria that directly apply to the activity/program (for example, Secretary of the Navy instructions rather than directives such as Office of Management and Budget circulars or Department of Defense instructions). An exception to this rule is the citation of a higher level directive that is needed for background information. Generally, citing the name and number of the criteria should suffice (for example, Secretary of the Navy Instruction 5200.35C). It should not be necessary to cite the section, paragraph, or subparagraph. If necessary, this information can be provided separately, either orally or in writing. The need to include a reference to a criteria section, paragraph, or subparagraph will be based on professional judgement.

829 -- CONDITION

Condition generally evolves from the auditor's comparison of the results of fact-finding procedures with appropriate evaluation criteria. Auditors should consider the following points in writing the discussion part of a finding:

- a. Make sure each condition is significant enough to warrant inclusion in a formal report.
- b. Make sure a finding is adequately supported, but limit the presentation of facts to the minimum necessary.
- c. Describe the universe and the audit scope, the time period covered, and the audit methodology (such as statistical sampling or procedural analysis).
- d. Quantify, where possible, rather than using indefinite adjectives such as "some," "many," "most," "often," or "sometimes."
- e. Avoid using the word "always" unless a single deviation from perfection is significant.

- f. Clearly identify sources of data used to support a finding. Sufficient audit work should be done to verify the correctness of data, regardless of source. Otherwise, any conclusion drawn based on the data should be qualified.
- g. Mention significant conditions affecting operations.
- h. Give credit when the command was aware of and working to correct previously recognized conditions, especially if command personnel pointed out the conditions to the auditors.
- i. Make sure that the conclusions (opinions) follow from the facts presented, and that they are clearly identified as conclusions.
- j. Clearly label and qualify results based on arithmetic samples/projections.
- k. Consider the use of photographs and graphics. Photographs included in audit reports to support findings must be accompanied by information as to their source (such as the local command) and the description of the photograph should state how it supports the finding to which it relates. Be sure to get permission before using photos that are copyrighted or attributed to an individual. Including graphic presentations is a useful device to convey maximum information in minimum reader attention time. A chart, graph, table or similar device will often replace many paragraphs. However, when used, they should be presented in a professional manner. Before spending time designing charts or graphs consult the editors, who may be able to create the visual more efficiently.
- l. Do not identify individuals or contractors by name or in any other way that could identify a particular individual or company.⁴⁸
- m. Use logic to support the need for corrective action rather than merely stating that regulations or other directives require the action. Regulations should, however, be cited to reinforce logically derived conclusions.
- n. Lay a solid foundation for each recommendation. This is particularly important when making an umbrella-type recommendation to correct a number of causes (for example, a recommendation to improve management or supervision). A carefully laid foundation is also particularly important to reinforce recommendations that auditees disagree with.

830 -- CAUSE

Cause answers the question "Why it happened," or in some cases, "Why it did not happen." When both auditors and management know the cause, they can more readily determine and agree on what action is needed to prevent a recurrence. In the case of noncompliance with regulations, the auditor should determine why management did not comply. In some cases the auditor may need to describe how a particular cause was isolated from other plausible factors.

⁴⁸ *The Director, Policy and Oversight Division must approve exceptions to this policy.*

- a. Only principal causes supporting recommendations need to be included in a finding. Auditors are not expected to determine or include all possible causes in a finding.
- b. The cause of a problem may be quite obvious and stated simply in a finding. Sometimes, however, the cause may be obscure and require a great deal of audit work and deductive reasoning. Then a relatively detailed explanation of the cause may be needed. Where underlying causes can be documented, the causes should be clearly described in reports.⁴⁹
A root or underlying cause is often the second or third tier cause versus the surface cause. For example, in a case where records are inaccurate, the surface cause may be the fact that the records aren't posted regularly. The records may not be posted regularly because the responsible individual (the poster) is not trained properly. The poster may not be trained properly due to a lack of funds. In this example, the root or underlying cause is the lack of funds.

831 -- EFFECT

1. **Effect shows the impact of the fact that the area/program being audited is not working the way it was supposed to.** Effects usually measure the significance of a condition. Commands must be convinced that the condition is important enough to warrant taking corrective actions. Reductions in efficiency or shortfalls in attaining desired program objectives or readiness levels are appropriate measures of effect. Where possible, effect should be expressed in quantitative terms such as lost dollars, potential future monetary benefits, number of personnel, units of production, quantities of material, number of transactions, or elapsed time. The effect should not be overstated.
2. Auditors must be sure to clearly label and qualify results based on sampling methods other than statistical, and to include sufficient information to show a reasonable basis for any estimates or projections. **Statistical results derived from one audit universe should not be projected outside that universe.** Potential monetary benefits resulting from a non-statistical sample are generally limited to the dollars identified from actual audit. If actual effects have not been fully developed, potential effects should be provided by the auditor to convince management of the need to take corrective action(s). In commenting on actual or potential effect, auditors must make sure that audit standards on sufficiency, competency, and relevancy of evidence are met.
3. When appropriate, it is important that the condition's impact on fleet operations be fully developed. Since the shore establishment exists to support the fleet, any opportunities to strengthen fleet operations and readiness arising from recommended shore establishment improvements should be pointed out. On the other hand, an unsubstantiated statement that a condition reduces fleet readiness is of no value.

832 -- CITATION OF STATISTICS

1. **General.** When statistics concerning estimates of population characteristics or potential dollar benefits are included in an audit finding, the following information will be provided:

⁴⁹ *Internal control weaknesses are normally not a result of noncompliance. Noncompliance is the condition. The cause of the noncompliance should be given. Internal control weaknesses are normally a cause.*

- a. Number of observations in the sample.
- b. Estimated or actual size of the population from which the sample was selected, including information on stratification of the population, if appropriate.
- c. Method of sample selection.
- d. Sample error rate (attribute) or projected values (variable) - the mean will be used for reporting benefits unless a one-sided projection is used and approved as described in paragraph [608.4e](#).
- e. Confidence level (reliability).
- f. Sampling precision (not required for a one-sided projection).

2. Presentation of projections. Except as approved in writing, in advance, by the applicable Assistant Auditor General, the statistical mean will be used in reporting statistical sampling results in audit reports. The term "random sample" will be used only for statistical sampling. Due care must be exercised when projections are made from sampling results. Projections must be adequately supported in the finding, and based on the appropriate (attribute or variable) sampling error rates. It is inappropriate to project attribute error rates to the dollar value of a universe. The following terminology may also be used when citing statistical sample results: "Based on a statistical sample of ... from a population of ...," followed by any of the phrases from the list below (all numbers are shown for illustrative purposes only):

a. Attribute sampling.

- (1) We can be 90 percent confident that a 100 percent examination would produce an error rate between (12.8) percent and (17.2) percent.
- (2) The probability is 90 percent that the true error rate is between (12.8) percent and (17.2) percent.
- (3) There is a 90 percent chance that the total number of errors in the population is between (2,560) and (3,440).
- (4) There is a 90 percent chance that the total number of errors is (15) percent plus or minus (1.2) percent.
- (5) No errors were observed and we are 90 percent confident that the error rate in the population of (10,000) is less than (6.25) percent.

b. Variable sampling.

- (1) We are 90 percent confident that a total examination would produce an average dollar error per document of somewhere between \$(1.20) and \$(3.40).

- (2) The probability is 90 percent that the true dollar error rate is between \$(1.20) and \$(3.40).
- (3) There is a 90 percent chance that the total value of the errors in the population is between \$(12,000) and \$(34,000).
- (4) There is a 90 percent chance that the total value of the errors in the population is \$(23,000), plus or minus \$(11,000).
- (5) No errors were observed in the random sample of (30). Thus, based on the size and value of the population of (10,000) valued at \$(12,345,678) we are 90 percent confident that the value of the errors in the population is less than \$(800,000).

c. Stratified variable sampling:

- (1) We performed a stratified random sample of the population of (9,876) and concluded that we are 90 percent confident that \$(555,555) plus or minus \$(44,444) worth of obsolete material was in the (xyz) warehouse.
- (2) We could not efficiently stratify the population because we had no price data and we did not believe that there was any correlation between any data elements and the (ABC) program. Nonetheless, the results of our random sample indicate that we can be 90 percent confident that there was at least \$(123,456) worth of Navy-owned material in the (xyz) warehouse.

Paragraph [608.4](#) provides related guidance.

3. Judgement sampling. When sampling is *not* done on a statistical basis, the population from which the sample is taken must be described and quantified, and the sampling method must be explained. The term "judgement sample" carries with it the particular responsibility to describe how the auditor's judgement was in fact exercised. **Judgement sample results cannot be projected for reporting potential monetary benefits.**

833 -- CORRECTIVE ACTION

Any pertinent action taken by an auditee during an audit should be mentioned. The wording should clearly recognize whether such corrective action was as a result of audit work and whether auditors have verified the action(s) taken. Verification may indicate that an approved management plan of action existed and implementation was in process during the audit phase.

834 -- POTENTIAL MONETARY BENEFITS

Potential monetary benefits will be shown in the discussion section of the finding but will not be included in a recommendation. The finding will discuss the potential monetary benefits (generally up to 6 years) and offsetting costs by year and appropriation. Management's concurrence or nonconcurrence on potential monetary benefits will also be stated in the discussion section. A nonconcurrence (or failure to comment) on potential monetary benefits will

result in an “Undecided” issue and will be identified as such in the Executive Summary and Sections B and C of the report. If management fails to state a specific position on the potential monetary benefits discussed in the finding, a statement to this affect will be included in the discussion paragraph of the finding. Management comments that cast doubt on amounts claimed should be fully addressed in our rebuttal comments. If management comments are accepted, the potential monetary benefits reported should be adjusted accordingly. **If potential monetary benefits are adjusted, the supporting rationale should be documented in the working papers.** Paragraph [608](#) provides additional details on reporting potential monetary benefits.

835 -- REPEAT FINDINGS

Repeat findings are similar conditions -- within the objectives and scope of the current audit -- that were reported within the previous 5 years by the Naval Audit Service or reported in any non-Naval Audit Service audit that is more current than the prior Naval Audit Service audit. Repeat status will be pointed out in the discussion segments of findings in Section B, in the Executive Summary, and in Section C. Repeat finding comments should identify why the condition still exists (for example, why previously agreed-to action was not taken). Repeat findings will be addressed to the immediate superior in command above the previous action addressee but no higher than the Assistant Secretary of the Navy level.

836 -- RECOMMENDATIONS

1. Recommendations are actions the auditor believes are needed to correct problems and improve operations. They answer the question, "What is the solution?"
2. Recommendations do not belong in the finding but should flow from the facts in the finding. Sometimes an explanation of how a recommended action will improve a condition is needed to sell the recommendation. To that extent, some paraphrased form of the applicable recommendation may be desirable in the finding to tie the conclusion to the recommended action. However, do not duplicate the recommendation language within the finding.
3. **The relationship between the audit recommendation and the underlying cause of the condition should be clear and logical.** When such a relationship exists, the recommended action will most likely be feasible and appropriately directed. **Each significant causal factor should carry a corresponding recommendation.**
4. If full corrective action will take significant time to complete, such as 1 year or longer, the auditor should make recommendations to improve conditions in the interim period. Milestones for corrective action should be established for the interim and long-term recommendations.
5. Recommendations to accomplish compliance with laws and regulations and improve internal controls should be made to management when significant instances of noncompliance are noted or significant weaknesses in controls are found. However, **recommendations should be specific and directed at resolving the cause(s) identified in the finding, including the cause(s) for noncompliance with laws and regulations.**

6. Changes to laws, directives, regulations, and instructions should be recommended when appropriate.
7. Recommendations should:
 - a. Address the cause(s) of reported problems, but not the problems themselves. **New matters should not be introduced in recommendations.**
 - b. **Be action oriented and specific** to improve, eliminate, or reduce negative conditions found and to be trackable under the followup process.
 - c. Be feasible and cost-effective.
 - d. Be addressed to the parties that need to act; generally the lowest command echelon(s) capable of correcting the condition.
 - e. Use action verbs and **avoid such terms as "ensure," "study," or "consider."**
 - f. **Where appropriate, specify a "quick fix or interim course of action** to get the immediate problem under control (e.g., collect overpayments to a contractor).
 - g. **Specify a long-range solution needed to fully resolve the underlying cause of the condition discussed in the finding.**

837 -- MANAGEMENT RESPONSES

1. Clarity. A management response should be clear as to the activity's or program manager's position on: the facts and conclusions in a finding; the recommendation(s); and, if applicable, potential monetary benefits and material internal control weaknesses. At a minimum, management should indicate concurrence or nonconcurrence with each recommendation, provide a target date for completion of action on recommendations it agrees with, and specifically indicate agreement or disagreement with any potential monetary benefits or material internal control weakness.

2. Terminology. A finding is considered "**Decided**" when the auditee and the auditor are in written agreement as to the action(s) needed to correct the reported deficiency and agreement has been obtained on monetary benefits. In deciding whether an audit issue is decided or undecided, the terms "concur" and "nonconcur" should always be viewed in light of the substantive content of the management response. For instance, a response prefaced "concur" but not setting forth any action to correct the reported condition should be treated as a nonconcurrence. Conversely, a response prefaced "nonconcur" but actually describing acceptable corrective action (regardless of whether the action is what was recommended) should be treated as a concurrence. Lastly, a response prefaced by a term such as "concur in principle," or "partially concur," should be considered "Decided" or "Undecided" based on the overall merits of corrective actions taken and planned. Paragraph [704](#) provides a more detailed explanation of the terms.

3. Nonreceipt. Nonreceipt of a management response within the timeframe established by the responsible Assistant Auditor General (normally 30 days) is considered the equivalent of a nonconcurrence. Assistant Auditor General approval is required to grant an extension. The Project Manager should explain to the activity/program manager that nonreceipt of management responses necessitates proceeding with the report publication process and indicating findings are “undecided”. As a general rule, report issuance will not be significantly delayed to obtain management comments or to seek resolution of disagreements.

4. Monetary benefits. Because of Department of the Navy and outside interest in monetary benefits, management responses to potential monetary benefits must specifically indicate concurrence or nonconcurrence with the benefits. If management specifies agreement with a potential monetary benefit but indicates the amount requires additional time to compute, the auditor calculated potential savings will be reported but shown as “open”. A negotiated or auditor determined reasonable date for receipt of management comments on the potential monetary benefits will be included in the Target Completion Date Column of Section C of the audit report. Management responses to potential monetary benefits should be briefly summarized in the discussion section of a finding. Management’s disagreement with potential monetary benefits will be reported as an “undecided” issue. Paragraphs [834](#) and [838.4b](#) provide further details on management responses to potential monetary benefits.

5. Reporting. An audit position may be modified on the basis of substantiated management comments. The auditee is to be advised that management’s comments will be presented in their entirety and verbatim in the report as an appendix including letterhead and signature block unless prohibited for privacy or security reasons.⁵⁰ The auditor’s basis for disagreement with management’s position will be included in the report. The auditee must also be advised that the audit report may be published without comments after the approved response date. Non-receipt of responses will be reported as “Undecided” issues. The names of individuals (other than the name of the person signing the response) or companies included in the management response will be deleted or otherwise blotted out prior to report publication. If management has classified its response "For Official Use Only," the respondent will be contacted to determine that portion of the response that should be so classified. If management’s response is properly classified, the report cover will also be marked "For Official Use Only." Paragraph [810.3](#) provides additional guidance.

838 -- AUDIT SERVICE COMMENTS

1. Need for review. If an activity’s written response indicates nonconcurrence with a finding, recommendation, potential monetary benefit, or material internal control weakness, both sides of the issue (the activity’s/program manager’s position and the audit position) must be carefully evaluated by audit management (to include the responsible Assistant Auditor General) to determine what action is warranted. Alternate solutions offered by management to acknowledged conditions should be examined with an open mind.

⁵⁰ For presentation purposes, management’s response will be reduced, fitted with a bold and black border on all four sides, with a right-hand margin titled "Notes." This will allow cross-referencing of page numbers from draft reports to final reports.

2. Audit position incorrect. If the audit position is found to be incorrect, action must be taken to modify or delete the finding/recommendation. If the finding/recommendation is significantly revised, it must be re-utilized with the recommendation addressee before being published. Such actions must be documented in the working papers.

3. Management's position incorrect. If the recommendation addressee's position is considered partially or totally incorrect, **reasonable action must be taken to secure a good management response statement.** The specific action that needs to be taken varies by audit and is a matter of professional judgement. **At a minimum, the Project Manager or Audit Director should make sure that whoever signed out the responses is specifically aware of what is considered incorrect about the response statement.** Where appropriate in the particular circumstances, audit managers should **suggest specific revisions to the management position that would be acceptable.** As a general rule, the responsible Assistant Auditor General should approve such suggestions in advance. In any case, report issuance should not be unreasonably delayed to obtain improved management responses.

4. Audit comments. Audit comments on management's position should briefly, but clearly, indicate whether planned and/or completed management actions will resolve the reported conditions.

- a. When the recommendation addressee disagrees with a recommendation for reasons believed to be insufficient, the audit comments will offer a brief but discrete rebuttal addressing the pertinent issues.
- b. If management questions the reasonableness of the amounts claimed as potential monetary benefits, the audit comments must address the management concerns and reinforce the audit position on the potential monetary benefits to justify claiming the amounts as being achievable once management takes the recommended action.
- c. Audit comments should generally not introduce facts not previously contained in the finding or in management's comments. However, when it is necessary to introduce new facts, they should be incorporated and the recommendation addressee given an opportunity to provide revised management responses prior to report publication.

PART VII -- SECTION C

839 -- GENERAL

The linked document provides a sample ["Status of Recommended Actions and Potential Monetary Benefits,"](#) that will be used for Section C of audit reports. [Chapter 9](#) provides the requirements for a financial audit report.

1. Repeats. The "Finding No." column will include a "+" symbol preceding the finding number when the finding is a repeat condition.

2. Subject. This column will include a condensed version of recommendations from Section B. Directive/regulation citations will not be included in the abbreviated subject data.

3. Status. This column will show one of three terms: “Open”, “Closed”, or “Undecided.” A one-line entry will be made for each recommendation and related potential monetary benefit. If there is more than one addressee, separate line entries will be made in Section C. Care should be taken not to duplicate any reported potential monetary benefits. A recommendation will not be considered “Closed” until agreed-to corrective actions are completed and potential monetary benefits have been agreed to. If either a recommendation or the related potential monetary benefits are disagreed with, both the recommendation and related dollars are reported as “Undecided”.

4. Action command. This column will identify the lowest command echelon(s) capable of taking the recommended corrective action(s) or, for “Undecided” issues, the immediate superior in command above the nonconcurring command. For repeat findings, the addressee will be the level above the previous addressee. Recommendations should not be addressed higher than the Assistant Secretary of the Navy level.

5. Target date. The “Target Completion Date” column will show a planned completion date for “open” recommendations, or an actual completion date for “closed” recommendations. For “undecided” issues the planned completion date will be shown as 30 calendar days subsequent to the report publication date. Target dates will be entered in numeric form as Month/Day/Year (MM/DD/YY).

6. Potential monetary benefits. The “Potential Monetary Benefits \$000” columns will show the appropriate category, the net amount claimed, the agreed-to amount, and the amount not agreed to. Recurring monetary benefits (up to 6 years) will be reported by showing the phrase “various” or an appropriation symbol with an unspecified year, e.g. 17*1804.⁵¹

- a. Management agrees with the recommendation(s) and the claimed potential monetary benefits.** Status will be shown as “Open” (O) or “Closed” (C), depending on the entry in the Target Completion Date column. The amount in the claimed and agreed-to columns will include the potential monetary benefits identified by audit or agreed to between audit personnel and management during utilization. If the date in this column is earlier than the report publication date, the status will be “Closed”.
- b. Management disagrees with both the recommendation(s) and the claimed potential monetary benefits.** Status will be reported as “Undecided” (U). The Amount Claimed and Not Agreed To columns will include the potential monetary benefits identified by audit. The immediate superior in command will be included in the Action Command column. The Target Completion Date will be 30 calendar days subsequent to the report publication date.
- c. Management disagrees only with the potential monetary benefits.** Status will be reported as “Undecided” (U). The Amount Claimed and Not Agreed To columns will

⁵¹ When there is a recurring monetary benefit, an exhibit following Section C must be included. The exhibit should show the potential monetary benefit (including offsetting costs) by fiscal year and appropriation for up to 6 years.

include the potential monetary benefits identified by audit. The Target Completion Date will be 30 calendar days subsequent to the report publication date. The immediate superior in command will be included in the Action Command column.

- d. *Management agrees with the recommendation(s) and agrees that potential monetary benefits exist but indicates the amount of potential benefits requires additional time to compute.*** Status will be reported as “Open” (O). The Target Completion Date will include either a negotiated or auditor-determined reasonable date for receipt of management comments on the potential monetary benefits. The auditor claimed dollars will be shown in the Amount Claimed column. No dollars will be shown in the Agreed-To or Not Agreed-To columns. The command that has agreed to provide comments on the potential monetary benefits will be included in the Action Command column.⁵²
- e. *Management agrees with the recommendation(s) but fails to respond to the potential monetary benefits claimed.*** Status will be reported as “Undecided” (U). A failure by management to provide comments on potential monetary benefits or recommendations will be considered a disagreement by management. Paragraph [838.4b](#) provides related information.

7. Finding has no recommendation. When a finding has no recommendation (such as for an informational finding), the "Finding No." and "Subject" columns must be completed. All remaining columns of Section C will be left blank.

840 -- UPDATING COMPLETION DATES

- 1.** If the target completion date for a recommendation listed as “Open” in Section C will have elapsed before the report is published, the target completion date needs to be updated. For those situations, the recommendation addressee must be contacted before the report is published to determine whether corrective action has been taken on those recommendations.

 - a.** If the recommendation addressee indicates that corrective action has been taken, confirmation must be requested in writing. If written confirmation is received, the recommendation should be listed as “Closed”, with the actual date the action was completed, in Section C. The working paper file must document the circumstances supporting the changed date and the final report may be issued based on this action.
 - b.** If corrective action has not been taken, the recommendation should be listed as “Open” with a revised target completion date in Section C.
- 2.** If the recommendation addressee provides a revised target completion date prior to publication, the revised date will be shown in Section C. The recommendation addressee does not have to confirm a revised target completion date in writing before publication. However, the discussion/visit with the responsible person providing the revised target completion date must be documented in the working papers. If the management response does not state an actual completion date but merely states that action was completed, insert the date of the management letter advising of this fact.

⁵² *The finding will include a statement that management agrees with the potential for monetary benefits.*

841 -- CLOSED RECOMMENDATIONS

A recommendation shall be classified “Closed” if (1) the management response affirmatively states that the recommended action has been taken or the substance of the stated corrective action has resolved (or should resolve) the reported condition and, (2) when applicable, agreement has been reached on potential monetary benefits.

842 -- REPORTING MONETARY BENEFITS

1. Each potential monetary benefit reported in Section C will show one of the following categories.

A: One-time potential funds put to better use.

B: Recurring potential funds put to better use for up to 6 years.

C: Indeterminable/immeasurable.

2. If a recommendation has no related potential monetary benefits, the columns for potential benefits will be left blank.

PART VIII -- OTHER ISSUES

843 -- EXHIBIT, APPENDIX, & GLOSSARY

1. An exhibit, generally created by the Audit Service, is used to display financial, statistical, or operational data. Exhibits will indicate the source of data. An appendix is used to display supplemental material supporting an audit or management position, and can be generated inside or outside the Audit Service.

2. Exhibits will be numbered as they occur within the report. Exhibits and appendixes will be presented as Exhibit (Appendix) 1, Page 1 of 3, Page 2 of 3, etc. If there is only one exhibit or appendix, the letter or number is not needed.

3. When extensive use of technical terms cannot be avoided because of the nature of the subject matter, a Glossary will be used. The Glossary should define any technical or unusual terms associated with the audited organization, function or activity that a reader needs to know to fully understand information in the report. The Glossary will be included in the report following the appendix that displays management’s comments.

844 -- CLASSIFIED OR FOUO REPORTING

1. **Classified.** When a report includes findings discussing classified matters, these may either be included in the regular audit report, properly classified, or reported in a separate classified and cross-referenced supplemental report. Classified reports will be marked and handled in accordance with the Department of the Navy Information and Personnel Security Program

Regulations ([Secretary of the Navy Instruction 5510.36\(Series\)](#) and [Secretary of the Navy Instruction 5510.30 \(Series\)](#)). Additional guidance on handling of classified material is contained in paragraph [512.3](#) and [618.1b](#).

2. FOUO. Reports containing "For Official Use Only" (FOUO) information will be marked and handled in accordance with guidance provided in paragraphs [810.3](#) and [837.5](#).

845 -- NUMBERING

1. The editors will assign audit report numbers after the report is signed.
2. Reports will be dated when telecommunicated to the auditee(s)/printer by the editors and simultaneously placed on our WEB site.

846 -- AUDIT REPORT DISTRIBUTION

All reports (unclassified and classified) will be forwarded to the editors for publication. At a minimum, audit reports will be distributed in accordance with "[Report/Announcement Letter Distribution and Coordination List](#)" guidelines. **Ultimately, the editors distribute reports based on the distribution list provided by the Project Manager/Audit Director.** Published audit reports normally receive full distribution and are normally posted on our WEB site. On an exception basis, distribution may be limited on request audits. The responsible Assistant Auditor General must approve limited distribution. "Copy to" distribution should be included as a separate report appendix. The appendix is entitled "Others Receiving Copies of this Report."

847-- FORMAT FOR REPORTS OF OTHER EFFORTS

1. **Commercial Activity Reviews.** These are business sensitive reviews performed at the request of commands.
 - a. Commercial Activity Reviews generally result in a letter report. The reports on these reviews are of a sensitive nature. They are to be classified "Procurement Sensitive" and distribution shall be limited to those organizations or activities having a need to know. Two copies of each final report, without cost analysis sheet enclosures, are to be provided to the Chief of Naval Operations (N465) or the Commandant of the Marine Corps (Code R), as applicable.
 - b. A Confidential Financial Disclosure Report (OGE 450) and/or a Certificate of Non-Disclosure may be required from individual addressees before distribution of sensitive commercial activity reviews and procurement audits. If mailing is required, especially prior to bid award, the completed business sensitive cost validation will be protected in the same manner as other classified material in accordance with [Secretary of the Navy Instruction 5510.36\(Series\)](#).
2. **Unannounced Disbursing Audits.** Unannounced Disbursing Audit reports will generally be letter reports. Further, the following information will be included under the appropriate captions:

- a. A statement of when and where the audit was conducted. If multiple locations are involved (such as at personnel support activities) and not all were audited, the statement must show all locations and identify those that were audited.
- b. A statement of the auditee's disbursing symbol; the size of operations (that is, the number of pay accounts held and the total disbursements for a representative period); and the total accountability, including agents, alternates, and branches.
- c. A statement that funds held were accounted for by actual cash count, and those documents representing cash were confirmed to the extent deemed appropriate. Of course, cash or documents representing cash that could not be accounted for should be appropriately discussed. Also, state the date of the cash count, whether or not it was unannounced, and, for multiple locations, whether or not reviews were simultaneous.

3. Reporting results of survey work. After the survey has been completed and a decision has been made not to continue into the verification phase, the results of the survey effort must be reported. When survey work results in a positive conclusion (such as when no material deficiencies are indicated) or finding, or when the auditor concludes that an area has been performed particularly well, a letter report will briefly describe the basis for those conclusions (paragraph 822 applies). It is important to communicate positive conclusions or findings in such a way that, if applicable, the limited basis for the conclusions, or other caveats related to the depth of the work performed, are easily and fully understood by all concerned.

848 -- FREEDOM OF INFORMATION ACT

1. Approval of request. Initial requests for information under the Freedom of Information Act must be approved or denied by the Auditor General of the Navy. However, if desired, the requester may appeal to the next and final authority (the Secretary of the Navy), as allowed by [Secretary of the Navy Instruction 5720.42\(Series\)](#).

2. Procedures.

- a. *All* requests for information under the Freedom of Information Act will be forwarded to the Assistant Auditor General for Plans, Policy, and Resources for action. The request will either be granted or denied by the Auditor General of the Navy based on [Secretary of the Navy Instruction 5720.42 \(Series\)](#) guidelines. If denied, the requesting party will be notified of that decision and provided the proper address for appealing to the Secretary of the Navy.
- b. In those instances where audit reports contain "For Official Use Only" (FOUO) information, the Project Manager must identify the specific information that is FOUO. This will assist in processing requests for information under the Freedom of Information Act. This information will be documented in the working papers.

849 -- MEDIA REQUESTS

1. While audit reports are the most frequent subjects of Freedom of Information Act requests, the provisions below are equally applicable to all other types of information requested by the media.
2. When members of the media contact auditors for audit information, they may acknowledge that an audit is ongoing. Beyond that, they are to diplomatically indicate that they must check with their supervisor, and then do so. The supervisor will coordinate with the responsible Assistant Auditor General and the Assistant Auditor General for Strategic Sourcing and Resources Management before responding further to a media request.
3. Media requests for copies of audit working papers or other documents should be referred in writing to the Auditor General of the Navy, through the Assistant Auditor General for Strategic Sourcing and Resources Management.

850 -- POST-PUBLICATION ACTIONS

1. **Telecommunicating final reports.** At the same time an audit report is released to the printer or otherwise distributed, the editors will telecommunicate the data file relative to Section C to the Assistant Auditor General for Strategic Sourcing and Resources Management.
2. **Audit Finding Index System.** The Audit Finding Index System contains information about each audit finding published during the last 5 years, including audit number, audit title, publication date, finding number, finding title, and summary paragraph. On a quarterly basis, this information will be included in the database for each published audit report.
3. **Review of addressees' responses.** An audit is not complete until all recommendations are "closed". Therefore, the Project Manager/Audit Director should pursue post-publication actions with the same intensity as before report publication.
 - a. The responsible Project Manager/Audit Director must evaluate management comments received regarding "undecided" issues in published audit reports to include followup correspondence indicating changes in previous comments. Such correspondence may indicate nonconcurrence with audit facts, conclusions, recommendations, or potential monetary benefits.
 - b. When a management comment apparently resolves an issue, the responsible Assistant Auditor General must notify the Strategic Sourcing and Resources Management Directorate in writing that the Project Manager/Audit Director agrees.
 - c. If a management comment does not resolve an issue, the responsible Assistant Auditor General must prepare and submit a position of exception to the management comment. The Assistant Auditor General's signed position should be provided to the NAVINSGEN (NIG-04) with a copy to the Assistant Auditor General for Strategic Sourcing and Resources Management within 10 workdays after receipt of the management comment. Comments may be telecommunicated but must be confirmed in writing.

- d. Exceptions taken to any comment shall include sufficient facts to fully support the Assistant Auditor General's position. Attempts will be made to resolve differences by correspondence or conference with action addressees. Assistant Auditor General representatives should attend these conferences. The responsible Assistant Auditor General will evaluate the position of management and either elevate the finding to the next echelon or defer to management. Results of these meetings and decisions made must be documented and included in the working papers.
- e. Secretary of the Navy Instruction 5200.34(Series) and public law establishes a **6-month timeframe for resolving all undecided issues in published audit reports.**
- f. Assistant Auditor General for Strategic Sourcing and Resources Management files should include all post-publication correspondence. Other Assistant Auditor Generals should ensure that all such correspondence is forwarded to the Assistant Auditor General for Strategic Sourcing and Resources Management.

4. Changes to published reports. Any changes to published reports must be approved by the responsible Assistant Auditor General. At a minimum, the Assistant Auditor General should issue a letter changing the report. The letter can describe the changes; provide notification of withdrawn findings; or, transmit a revised report or corrected pages. Other procedures that must be followed are:

- a. Use the same audit report and audit job order numbers as the original report.
- b. Use a *different* publication date for audit resolution purposes.
- c. Describe changes made to the report in the transmittal letter if a revised report is issued.
- d. Update target completion dates, as needed.
- e. Check the status of "Undecided" issues with the Assistant Auditor General for Strategic Sourcing and Resources Management and update the status to "Closed" or "Open", if applicable.

5. Review of Title 31, U.S. Code, Section 1517 nonviolation reports. When the audit report contains a finding disclosing a potential Antideficiency Act violation, within 10 business days of receipt of the draft report, the Assistant Secretary of the Navy for Financial Management and Comptroller (FM&C) shall request that a preliminary review of the potential violation be initiated within the next 30 days. The Naval Audit Service is to be advised on the status of the preliminary review. If the preliminary review confirms that a potential violation has occurred, a formal investigation is required.

PART IX -- REPORT PROCESSING

This section describes the processing flow for the draft audit report, from finding development through release.

851 -- FINDING OUTLINE WORKSHEET

1. Because of the complex nature of audit findings, auditors generally are not able to effectively write them "off the top of their heads." Attempts to draft findings this way in the past have resulted in unnecessary rewriting, and, in worst-case situations, publication of findings that lacked one or more of the four essential finding attributes or contained flaws in logic.
2. The [Finding Outline Worksheet](#) was developed to:
 - a. Ensure that each finding has six key components:
 - (1) The four attributes of a finding (condition, cause, effect, and criteria)
 - (2) An adequate description of the auditors' methods and the results of the review.
 - (3) Effective recommendations.
 - b. Ensure that the logical relationships among the six key components are sound.
3. The [Finding Outline Worksheet](#) can be used in the following manner:
 - a. Using brief guidance on the back of the worksheet or detailed guidance in this chapter, the auditor develops concise statements of the condition, cause, effect, criteria, and recommendations. The auditor also develops a concise description of the methods used to do the review. This step is especially important in performance audits, where auditors do not always have clear-cut regulations to rely on as criteria.
 - b. After reviewing the worksheet to ensure each information element on the worksheet has been stated precisely and the logical relationships are sound, the auditor presents the worksheet to the Project Manager for review.
 - c. The Project Manager makes any necessary revisions in consultation with the auditor. Careful analysis at this point of finding components, such as cause, effect, and recommendations, can prevent problems such as the need to drop or significantly revise findings after they have been drafted.
 - d. Once the Project Manager decides the worksheet portrays the key components of the finding properly, the worksheet is initialed and dated by the auditor and Project Manager and provided to the Audit Director for approval. The Audit Director will indicate agreement with the contents of each finding worksheet by initialing and dating the sheet before the finding is completely drafted. Direction will be provided to the Project

Manager on a [Working Paper Review Sheet](#). Copies of both the [Finding Outline Worksheet](#) and the related Working Paper Review Sheet will be placed in the working papers.

852 -- DRAFTING THE FINDING

After the Project Manager has approved the finding outline worksheet, the auditor drafts the finding. Normally, the condition, cause, effect, and criteria statements can be copied directly from the worksheet to form the "Synopsis" paragraph of the finding. Similarly, the recommendations can be copied from the worksheet into the finding. When writing the description of the audit methods and review results, the auditor will usually need to elaborate on the information in the worksheet.

853 – PROJECT MANAGER REVIEW

The Project Manager should not need to make heavy revisions of the draft if it conforms to the worksheet approved earlier. After reviewing the draft finding, the Project Manager will provide a copy to the Audit Director prior to any discussion with the audited personnel. The draft finding may be provided for an editor's review after the Audit Director approves it. Draft reports should be processed in the same manner as draft findings.

854 -- EDITOR REVIEW

1. The editors perform "copy editing" of draft and final reports. This includes looking for grammar, formatting, and sentence structure problems and making those corrections. Using the guidesheets in the ["Editors' Checklist--Draft Reports"](#), or comparable guidesheets that cover at least the same points, the editors also check to ensure that draft reports conform to the reporting standards for content and style.
2. The editor will provide copies of the completed guidesheets to the PM, AD, and AAG responsible for the audit. **The AAG is responsible for ensuring that the appropriate changes are made to the draft report before returning the report to the editors for a final "copy edit" prior to electronic distribution by the editors.**

855 – AUDIT DIRECTOR REVIEW

After an Audit Director has completed his or her review of a draft report, inclusive of changes recommended by the editor, he or she will present the report to the Assistant Auditor General who will arrange for referencing (paragraph [511](#) applies).

856 – ASSISTANT AUDITOR GENERAL REVIEW

The Assistant Auditor General will review the draft report package, including the editor's guidesheets, after incorporation of any needed changes as a result of referencing.

857 -- POST-UTILIZATION PROCESSING

Post-utilization processing is discussed in paragraph [622](#). If this processing results in significant content changes, the Assistant Auditor General must decide whether additional referencing is required. The editor will scan in management responses and ensure that Naval Audit Service comments appropriately address those responses. The editors will also perform a final “copy edit” of Final Reports, and a preprinter review using the [“Editor’s Checklist--Final Reports”](#) prior to electronic distribution.

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901 -- GENERAL POLICY

This chapter presents the form and content of financial audit reports that are required by the Chief Financial Officers Act of 1990 (CFO Act), the Federal Financial Management Act of 1994, and the Federal Financial Management Improvement Act of 1996. In addition, the provisions of this chapter apply to any other financial or financial-related audit performed by the Naval Audit Service. A separate financial audit report is to be prepared for each reporting entity, i.e., a group of related or unrelated revolving funds, trust funds, commercial functions, and/or other accounts. The report format outlined below includes subject matter generally required for a financial audit. Additionally, auditors should be familiar with the reporting requirements promulgated by the Office of Management and Budget (OMB) and the Comptroller General of the United States for CFO Act financial audits. Any audits performed for the Inspector General, DOD, as part of a DOD-wide audit of General/Working Capital Funds should consider special reporting requirements, as promulgated by the Inspector General. Reporting on audit assistance by other audit organizations is addressed in paragraph [915](#). Other concerns for financial audits, such as materiality and representation letters, are discussed in paragraph [609](#).

902 – FORMAT

The format below can be used to report the results of all financial audits. Section B results may be reported in separate reports to facilitate meeting established report deadlines.

- Cover.
- Transmittal letter.
- Table of Contents.
- Executive Summary.
- Section A - Introduction, including Background, Objectives, Scope, and Methodology.

The "Cover," "Transmittal letter," "Table of Contents," "Executive Summary," and "Section A," of financial audit reports will generally follow the same form and content as performance audit reports discussed in paragraphs [801](#) through [821](#).

- Section B: Results of Audit Work
 - Part I -- Report on Auditor's Opinion on Principal Statements and Consolidating Statements.
 - Part II -- Report on Internal Controls (summarize findings if appropriate).
 - Part III -- Report on Compliance with Laws and Regulations (summarize findings if appropriate).
 - Part IV -- Findings and Recommendations that affect financial statements.

This section of the report will include all recommendations, including those findings summarized in Parts II and III and, for final reports, a summary of management responses and Audit Service comments. Management's response will be reproduced in its entirety as an appendix to the report.

- Section C - Status of Recommendations and Potential Monetary Benefits (similar to Section C of the standard report format as discussed in paragraphs [839](#) through [842](#)).
- Section D - Financial Statements:
 - Overview of the Reporting Entity.
 - Principal Statements and Related Notes.
 - Balance Sheet.
 - Statement of Changes in Net Position.
 - Statement of Net Cost.
 - Statement of Budgetary Resources.
 - Statement of Financing.
 - Statement of Custodial Activity.
 - Notes to Principal Statements.
 - Required Supplemental Stewardship Information (If applicable).
 - Required Supplemental Information (If applicable).
 - Other Accompanying Information (If applicable).
- Exhibits and Appendices (as needed).

903 -- EXECUTIVE SUMMARY

The executive summary will generally follow the same format as for a standard performance audit report described in paragraphs [814](#) through [817](#); however, within the "conclusions" section, the executive summary for a reporting entity financial statement audit will contain a brief statement entitled "***Report on Auditor's Opinion on the Financial Statements.***" This statement will summarize the opinion letter contained in Section B, Part I. The executive summary will also include statements on internal controls and compliance with laws and regulations to briefly explain those portions of the audit, unless those portions are reported separately.

SECTION A

This section contains the background information, and description of the objectives, scope, and methodology of the audit.

904 – BACKGROUND

The background must present information needed to introduce the audit to general readers in such a manner that they will understand the fund or entity being audited and understand the issues discussed in the internal controls and compliance reports. In addition to the requirements discussed in paragraph [818](#), this section should provide the reader with information and details as to why the audit was performed. When applicable, discuss the CFO Act of 1990, the Federal Financial Management Act of 1994, and the Federal Financial Management Improvement Act of 1996, or mention that the audit is part of a DOD-wide audit of General/Working Capital Funds.

905 -- OBJECTIVES, SCOPE, AND METHODOLOGY

The statement of objectives tells the reader why the audit was performed and what the audit set out to accomplish. The scope section tells the reader what the auditor did and did not do to accomplish the audit's objectives. The methodology section explains how the auditor went about accomplishing the audit. Paragraphs [819](#) through [821](#) provide guidance on objectives, scope, and methodology. The following additional information should be provided for financial or financial-related audits and modified as conditions warrant.

1. Objectives. Financial statement audits under the CFO Act, the Federal Financial Management Act of 1994, and the Federal Financial Management Improvement Act of 1996 should include the following objectives:

- a. Determine whether the Principal Statements and Related Notes and, where applicable, Consolidating Statements present fairly in all material aspects the financial position, results of operations and changes in net position and cash flows, in accordance with federal generally accepted accounting principles.
- b. Determine whether the reporting entity has an internal control structure that provides reasonable assurance of achieving the internal control objectives.
- c. Determine whether the reporting entity has complied with laws and regulations that could have a direct and material effect on the financial statements.
- d. Determine whether the information and manner of presentation in the Overview of the Reporting Entity and in the Supplemental Financial and Management Information sections are materially consistent with the information in the Principal Statements and Related Notes and, where applicable, the Consolidating Statements.
- e. To the extent possible, assess the reliability of performance data presented in the review of the Reporting Entity and/or the Supplemental Financial and Management Information.

2. **Scope.** The scope should describe the tests of compliance made by the auditor.
3. **Methodology.** The audit report shall state that the audit was made in accordance with generally accepted government auditing standards and the provisions of the [current OMB Bulletin on "Audit Requirements for Federal Financial Statements."](#)

SECTION B

Section B will contain the reports, including all recommendations, a summary of management responses, and Audit Service comments.

906 -- PART I - REPORT ON AUDITOR'S OPINION

The Report on Auditor's Opinion on Principal Statements and Consolidating Statements will include the elements described below, as applicable. The report will be addressed to the heads of the components responsible for management of the fund and preparation of the financial statements, and signed by the Assistant Auditor General for Financial Audits.

1. Content of the auditor's opinion.⁵³ The auditor's opinion identifies the financial statements audited, describes the nature of the audit, and expresses the auditor's opinion on the financial statements that were audited.⁵⁴ The report should state:

- a. That we have audited the financial statements of the reporting entity (and identify the specific financial statements that we audited and the time period covered by those statements).
- b. That the financial statements are the responsibility of the auditee's management.
- c. That the auditor is responsible for expressing an opinion on the financial statements based on the audit.
- d. That the audit was conducted in accordance with OMB Bulletin 0x-xx ([the current OMB guidance on "Audit Requirements for Federal Financial Statements"](#) in effect at the time of the audit) and generally accepted government auditing standards (GAGAS) issued by the Comptroller General as implemented by the Naval Audit Service (including qualifying statements if needed).
- e. That GAGAS require that the auditor plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.
- f. That the audit included:

⁵³ The content of an opinion on financial statements is described at length in AICPA Statement on Auditing Standards (SAS) No. 79. See SAS No. 79 for additional information and sample language.

⁵⁴ See AICPA SAS No. 79 for an illustrative Report on Auditor's Opinion.

- An examination of evidence supporting the amounts and disclosures in the financial statements.
 - An assessment of the accounting principles used and significant estimates made by management.
 - An evaluation of the overall financial statement presentation.
- g.** That the auditor believes the audit provides a reasonable basis for the opinion.
- h.** An opinion on whether the financial statements present fairly, in all material respects, the financial position of the audited entity as of the date of the Statement of Financial Position and the results of the reporting entity's operations and cash flows for the audit period in conformity with (cite the applicable accounting policy). Variations on this portion of the report are described in "2b" through "2e" below.
- i.** The signature of the Assistant Auditor General for Financial Audits.
- j.** The date of the report on auditor's opinion (end of fieldwork).
- 2. Types of opinions.** The statements that follow are structured for the different opinions.
- a. Unqualified opinion.** "An unqualified opinion states that the financial statements present fairly, in all material respects, the financial position, results of operations, and cash flows of the audited entity in conformity with applicable accounting standards."⁵⁵
- b. Explanatory language with an unqualified opinion.** The following circumstances, while not prohibiting an unqualified opinion on the financial statements, may require explanatory language following the opinion paragraph.
- (1) The opinion is based partially on the report of another auditor.
 - (2) The financial statements contain a departure from applicable accounting standards. However, this applies to an unqualified opinion only when, due to unusual circumstances, the departure **prevents** the statements from being misleading. This provision may be revised to reflect alternative standards in the first years of these audits.
 - (3) The financial statements are affected by uncertainties concerning future events and the auditor cannot reasonably estimate the outcome or effects on the financial statements. If an explanatory paragraph is required for this reason, the report should describe the matter causing the uncertainty and indicate that its outcome cannot be determined. The uncertainty should not be referenced in the introductory, scope, or opinion paragraphs of the report.

⁵⁵ Statement from AICPA SAS No. 79, January 1989, amended to refer to Federal standards.

- (4) Between accounting periods, there has been a material change in accounting principles or in the methods of their application.
 - (5) The auditor has updated an opinion on a prior year's financial statements from adverse to unqualified.⁵⁶
 - (6) The auditor must issue a disclaimer on the prior year's unaudited figures, which form part of the basis for current financial statements (this will be required for the first year in which financial statements are audited if an unqualified opinion is being given).
 - (7) The auditor has concerns about the supplementary information required by the Federal Accounting Standards Advisory Board (FASAB) or OMB because:
 - The supplementary information has been omitted.
 - The presentation of such information departs materially from FASAB or OMB guidelines.
 - The auditor cannot complete prescribed procedures with respect to such information.
 - There is substantial doubt about whether the supplementary information conforms to FASAB or OMB guidelines.
 - (8) Other information in a document containing audited financial statements is materially inconsistent with information appearing in the financial statements.
 - (9) Information is presented according to applicable guidelines, but the auditor determined that it was of little or no actual (or potential) benefit to management in the form presented.
- c. Qualified opinion.** A qualified opinion states that, except for the effects of the matter to which the qualification relates, the financial statements present fairly the financial position of the audited entity in conformity with applicable accounting standards. Such an opinion is expressed when:
- Insufficient evidence or restrictions on the scope of the audit make an unqualified opinion imprudent; or,
 - The financial statements contain a departure from Federal accounting standards or other applicable guidelines, and the effect of the departure is material, but the auditor has decided not to express an adverse opinion.

All the substantive reasons for expressing a qualified opinion should be disclosed in paragraphs preceding the opinion paragraph. These paragraphs should also describe the principal effects on the auditee's financial position of the conditions that resulted in the

⁵⁶ See AICPA SAS No. 79, paragraphs 68 & 69.

qualified opinion. If the effects could not reasonably be determined, the report should so state. If any of the conditions that require a qualified opinion are fully disclosed in notes to the financial statements, referring to these notes may shorten the explanatory paragraphs in the report on the auditor's opinion. The opinion paragraph should include qualifying language and a reference to the explanatory paragraphs. A qualified opinion should clearly indicate areas that are of concern.

The auditor must not prepare any of the basic financial statements for the audit report if the audited entity did not provide the statement(s). In this case, the auditor should qualify the report by indicating what was not provided, state that the absent financial statement is required by Federal accounting standards, and state that the absence of the required statement results in an incomplete presentation of financial position.

- d. Adverse opinion.** "An adverse opinion states that the financial statements do not present fairly the financial position or the results of operations or cash flows in conformity with [Federal] accounting standards or other applicable accounting standards."⁵⁷ Paragraphs preceding the opinion paragraph should state all the substantive reasons for the adverse opinion, including the reliability of automated data processing systems if applicable. Explanatory paragraphs should also state the principal effects on the financial position, results of operations, and cash flows of the subject matter resulting in an adverse opinion. If the effects cannot reasonably be determined, the report should so state.
- e. Disclaimer of opinion.** There are two primary reasons for issuing a disclaimer of opinion. One relates to a scope limitation, and the other relates to the condition of the financial statements.

 - (1)** If the auditor has not performed an audit sufficient in scope to form an opinion on the financial statements, the report will contain a disclaimer of opinion. If the disclaimer results from a scope limitation, indicate in separate paragraphs the reasons why the audit did not comply with generally accepted government auditing standards or OMB guidance and that the scope limitation precludes the expression of any opinion. The auditor should not describe the procedures that were performed and should not include the standard paragraph that describes what an audit involves. Such statements might erroneously lead the reader to believe that coverage was adequate. The auditor should disclose any other reservations regarding the fair presentation of the financial statements.
 - (2)** If a disclaimer is required because of the condition of the financial statements, the auditor should validate the closing balances where possible and make recommendations to strengthen the financial reporting systems in order to produce adequate financial statements for future years. Such recommendations will be made in Part IV of Section B.

⁵⁷ Statement from AICPA SAS No. 79, amended to refer to Federal standards.

907 -- PART II - REPORT ON INTERNAL CONTROLS

A written report should be prepared on the auditor's understanding of the entity's internal control structure and the assessment of control risk made as part of a financial statement audit, or a financial-related audit. The report should include as a minimum: (1) the scope of the auditor's work in obtaining an understanding of the internal control structure and in assessing the control risk; (2) the entity's significant internal controls or control structure, including the controls established to ensure compliance with laws and regulations that have a material impact on the financial statements and/or the area subject to a financial-related audit; and (3) the reportable conditions, including the identification of material weaknesses, identified as a result of the auditor's work in understanding and assessing the control risk.

1. Internal control structure. The report should state that establishing and maintaining the internal control structure are management's responsibilities, and should explain the general objectives and the inherent limitations of any internal control system. The report should also indicate that the auditor considered the auditee's internal control structure in determining audit procedures that were needed in order to express an opinion on the financial statements. The report should clearly indicate that the audit is not intended to provide assurance of the adequacy of the reporting entity's overall internal control structure. The report should also define "material weakness."⁵⁸

2. Reportable conditions.

- a.** For the purposes of the internal control report, a reportable condition is a matter coming to the auditor's attention that, in the auditor's judgement, should be communicated because it represents a significant deficiency in the design or operation of the internal control structure, which could adversely affect the organization's ability to meet the control objectives of making sure that:
 - Obligations and costs are in compliance with applicable law.
 - Funds, property, and other assets are safeguarded against waste, loss, unauthorized use, or misappropriation.
 - Revenues and expenditures applicable to agency operations are properly re-corded and accounted for to permit the preparation of accounts and reliable financial and statistical reports and to maintain accountability over the assets.
- b.** The Report on Internal Controls should define "reportable conditions," describe the specific reportable internal control deficiencies noted during the audit, explain the deficiencies in relation to Federal accounting standards or other applicable standards, and refer to recommendations in Part IV. It should also describe the known or potential

⁵⁸ *A material weakness in the internal control structure is a reportable condition in which the design or operation of one or more of the elements of the internal control components does not reduce, to a relatively low level, the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and would not be detected within a timely period by employees in the normal course of performing their assigned functions.*

effect(s) of the deficiencies, especially in relation to the financial statements and the information that management relies on in operating the audited entity. If the effects cannot reasonably be determined, so state. The conditions and effects should be supported in enough detail to convince the reader that there is a problem and that recommendations should be implemented. In many cases, a statement on frequency of occurrence and an example may be sufficient detail. In some cases, lack of internal controls may mean lack of an audit trail. In those cases, the auditor may only be able to indicate there is no assurance that certain types of errors or abuses did not occur. In other cases, comparison of the auditee's procedure to a Federal accounting standard or other applicable standard may be sufficient.

- c. The report should indicate specific conditions that are considered material weaknesses, as defined in the background, and clearly identify any condition that will result in a qualified or an adverse opinion on the financial statements.
- d. The signature of the Assistant Auditor General for Financial Audits
- e. The date of the report on internal controls (end of fieldwork).

908 -- PART III - REPORT ON COMPLIANCE

1. The Report on Compliance with Laws and Regulations should indicate that any reported noncompliance was considered in preparing the auditor's opinion on the financial statements. The report should state that management is responsible for complying with applicable provisions of laws, regulations, contracts, and grants.

2. The audit should report a condition of noncompliance:

- a. If the violation would result in material misstatement of the Principal Statements or Consolidating Statements, or if the sensitivity of the matter would cause it to be perceived as significant by others.
- b. If the auditor determines that the Federal Managers' Financial Integrity Act (FMFIA) process was not conducted in accordance with OMB guidelines for the evaluation, improvement, and reporting on internal control systems or if there is a conflict between the agency's most recent FMFIA reports and the auditor's evaluation of the entity's internal control system.
- c. If an agency is unable to present information required for inclusion in the Overview of the Reporting Entity and Supplemental Financial and Management Information and it fails to disclose such omission.
- d. If the absence or condition of documentation supporting the financial, statistical, and other information included in the Overview or the Supplemental Financial and Management Information could result in a misstatement or an inability to adequately defend or justify the information presented.

3. The report should be signed by the Assistant Auditor General for Financial Audits.
4. The report on compliance is dated (end of fieldwork).

909 -- PART IV - FINDINGS AND RECOMMENDATIONS

1. Internal control and noncompliance findings. If sufficient information is readily available to adequately support findings related to internal control deficiencies and noncompliance with laws and regulations, the auditor will draft specific finding(s) and recommendations, including findings related to previously recommended adjusting entries that were not made.

Recommendations of adjusting entries must be made. If sufficient information was not readily available to support a finding, but the condition will materially affect the financial statements, the auditor will perform sufficient audit work to disprove the condition, or to develop the condition and draft a finding(s).

2. Performance findings.

- a. Any performance findings and recommendations developed as part of the financial audit may be included in this part of the audit report or be reported separately. This part of the report will indicate that the finding(s) came to the auditor's attention during the audit. The findings will be incorporated as an additional part of the overall report on the financial statement audit if the conditions affect the financial statements. If there is no known effect on the financial statements, the performance finding(s) may be summarized or referenced in the overall report to provide a more complete record of the audit
- b. If the fieldwork in a financial statement audit reveals a potential performance-type finding that does not have a material effect on the current financial statements, the audit team should generally write an audit suggestion ([Project Planning Worksheet](#)) so the issue can be pursued at a later date. If the condition is time-sensitive, the auditor should advise the responsible Assistant Auditor General so work can be expedited.

SECTION D

910 – GENERAL

1. The financial statements provided to the auditor will be included as Section D of the overall report. They generally include:

- Overview of the Reporting Entity.
- Principal Statements and Related Notes.
- Balance Sheet.
- Statement of Changes in Net Position.

- Statement of Net Cost.
- Statement of Budgetary Resources.
- Statement of Financing.
- Statement of Custodial Activity.
- Notes to Principal Statements.
- Required Supplemental Stewardship Information (If applicable).
- Required Supplemental Information (If applicable).
- Other Accompanying Information (If applicable).

2. The statements contained in the report will be clearly marked with the name of the audited entity and the date(s) of coverage ("as of," "for the year ended," or "from ... to...") and will reflect adjusting entries made by management to fairly present the financial statements.

911 -- OVERVIEW OF REPORTING ENTITY

1. Each Annual Financial Statement should include a narrative "Overview of the Reporting Entity." This Overview should provide a brief description of the reporting entity, to include program and administrative highlights. It may also identify critical areas for financial and management improvement. The Overview should include a narrative discussion and analysis of the financial condition of the reporting entity. This discussion should present information based on the results of an analytical review of relevant financial and performance data of the programs, activities, and funds that make up the reporting entity. Important aspects of the reporting entity's financial operations should be discussed and relevant trends identified.

2. Wherever possible, financial data should be related to other measures of performance on a program-by-program basis. The inclusion of performance measures will facilitate using the financial statement to assess both financial and program performance. The Overview may identify programs or activities that may need significant future funding or may provide an early warning of other potential financial management problems.

3. In developing financial, statistical, and other information for presentation in the Overview, the reporting entity should prepare adequate supporting documentation and retain such documentation to facilitate future review and audit. In the event that information is not available to complete the foregoing narrative discussion and analysis of the financial condition of the reporting entity, management must discuss why such information is not available and describe its plan for meeting these reporting requirements in the succeeding year and future years.

4. Each applicable reporting entity is required to include performance measurements as a part of their financial statements. These performance measures, more commonly referred to as workload

indicators, provide quantification of the output of the entities for which financial statements are prepared. For industrial fund activities, separate performance measures should be provided for each activity group. For supply operation activities, separate performance measures should be provided for each stock fund division. For appropriated funds, separate performance measures should be provided for each budget activity/major force program. Performance measures should be expressed in both financial (dollar) and nonfinancial (workload) terms.

912 -- PRINCIPAL STATEMENTS AND RELATED NOTES

OMB defines the form and content of federal financial statements through issuance of an annual bulletin. For FY 2000, the bulletin is [01-02](#). The Comptroller, DOD then provides supplemental form and content guidance for the Military Departments. Auditors performing audits of financial statements should ensure that they are aware of the most recent form and content guidance from OMB and the Comptroller, DOD. Comparative information from prior years, to the extent it is readily available, should be included. The Office of the Under Secretary of Defense (Comptroller) publishes guidance on form and content. The guidance should be available from the Assistant Auditor General for Financial Audits.

- 1.** The Notes to the Principal Statements should contain all disclosures necessary to make the Principal Statements fully informative and not misleading. The Notes should be an integral part of the Principal Statements. The Notes should contain a discussion of all significant accounting policies, including:
 - a.** A definition of the reporting entity (including a list of funds and substantial commercial functions covered by the reporting entity).
 - b.** A definition of the basis of accounting for the reporting entity.
- 2.** The Notes should also disclose:
 - a.** The valuation basis on which major categories of assets are accounted for and reported.
 - b.** The nature of any significant restrictions on the use of assets.
 - c.** The amount and nature of any significant contingent liabilities.
 - d.** The composition of the entity's net position accounts (such as fixed assets).
 - e.** Any other information related to assets, liabilities, net position, revenues, and expenses considered necessary to disclose fully and clearly the reporting entity's financial position and results of operations.
- 3.** The Notes should also identify departures from the standards set forth in FASAB and OMB guidance including the financial statement disclosure requirements. The calculation of the financial impact of departures from these standards is not required, but, at a minimum, the notes

should discuss the nature of the differences and the financial impact to the extent the impact is known or can be readily determined.

913 – REQUIRED SUPPLEMENTARY STEWARDSHIP AND OTHER SUPPLEMENTARY INFORMATION

Each Annual Financial Statement should contain, where appropriate, Required Supplementary Stewardship and Other Supplementary Information which supports information presented in the Overview of the Reporting Entity, or which would otherwise enhance an understanding of the financial condition and operations of the reporting entity. Such information must be reported and audited in accordance with the most recent OMB and DOD guidelines.

914 -- QUICK REACTION REPORTS

During the course of the audit, activities will be advised of significant material issues and situations through the use of Quick Reaction Reports. These quick reaction reports will be issued as soon as possible during the audit to the lowest command level that can effect corrective actions. It is important to issue these quick reaction reports during the audit to allow management the opportunity to implement corrective actions prior to the issuance of our overall report. The overall report will cite the quick reaction report(s) issued. When this procedure is followed and adjusting entries are made during the audit, the final report will give credit to management for taking the necessary action. Paragraph [613](#) provides additional guidance on Quick Reaction Reports.

915 -- RELIANCE ON THE WORK OF OTHER AUDIT ORGANIZATIONS

1. Utilizing the audit assistance of another audit organization (e.g. the Office of the Assistant Inspector General for Auditing, DOD), requires adequate disclosure in our audit reports when we are responsible for rendering an audit opinion and issuing the related reports.
2. Our audit report will reference in Section A, Scope and Methodology, and Section B, Part I, the opinion paragraphs of the report, that a portion of the audit work was performed by another audit organization. The audit opinion should also disclose the magnitude of the portion of the financial statements audited by the other auditors. In addition, if the performing organization issues a formal report on their audit effort, the report title, date, and number should be cited in our report.